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DEVELOPMENTS IN GLOBAL INSURANCE REGULATORY AND SUPERVISORY FORUMS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

ON

RECEIVING AN UPDATE FROM TEAM USA ON DEVELOPMENTS IN GLOBAL INSURANCE REGULATORY AND SUPERVISORY FORUMS

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C O N T E N T S

THURSDAY, SEPTEMBER 12, 2019

	Page
Opening statement of Chairman Crapo	1
Prepared statement	23
Opening statements, comments, or prepared statements of:	
Senator Brown	3
Prepared statement	24

WITNESSES

Steven E. Seitz, Director, Federal Insurance Office, Department of the Treasury	4
Prepared statement	25
Responses to written questions of:	
Senator Toomey	35
Senator Menendez	35
Senator Warren	36
Senator Sasse	39
Senator Cortez Masto	41
Senator Sinema	46
Thomas Sullivan, Associate Director, Board of Governors of the Federal Reserve System	6
Prepared statement	28
Responses to written questions of:	
Senator Toomey	46
Senator Menendez	46
Senator Warren	47
Senator Sasse	49
Senator Cortez Masto	51
Senator Sinema	55
Eric A. Cioppa, Superintendent, Maine Bureau of Insurance, on behalf of the National Association of Insurance Commissioners	7
Prepared statement	30
Responses to written questions of:	
Senator Toomey	56
Senator Menendez	57
Senator Warren	57
Senator Sasse	60
Senator Cortez Masto	61
Senator Sinema	70

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Statement submitted by the National Association of Mutual Insurance Companies	71
Statement of the U.S. Chamber of Commerce	80
Letter submitted by the American Property Casualty Insurance Association	83
Statement submitted by the American Council of Life Insurers	91
Letter to European Regulators from Insurance Europe and the Pan-European Insurance Forum regarding the global Insurance Capital Standard (ICS), submitted by Senator Rounds	95
Letter from a coalition of Senators, dated May 13, 2019, to Randal K. Quarles, Board of Govenors of the Federal Reserve System, regarding the ICS, submitted by Senator Rounds	98

Page
Response from Randal K. Quarles, Board of Govenors of the Federal Reserve System, to Senators' May 3, 2019, letter 104

DEVELOPMENTS IN GLOBAL INSURANCE REGULATORY AND SUPERVISORY FORUMS

THURSDAY, SEPTEMBER 12, 2019

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order.

Today we welcome to the Committee the three members of Team USA representing the United States in international insurance supervisory and regulatory forums, including Steven Seitz, Director of the Federal Insurance Office in the Treasury Department; Thomas Sullivan, Associate Director at the Board of Governors of the Federal Reserve System; and Eric Cioppa, Superintendent of the Maine Bureau of Insurance, on behalf of the National Association of Insurance Commissioners.

On September 6, 2019, the Treasury and Federal Reserve issued their annual report regarding their efforts with the National Association of Insurance Commissioners in international forums, such as the International Association of Insurance Supervisors.

The report and accompanying testimony are required by the Economic Growth, Regulatory Relief, and Consumer Protection Act to encourage greater transparency into and reinforce a unified approach to efforts by Team USA at those international forums.

A key driver of this provision is the IAIS's multiyear effort to develop a group-wide, risk-based insurance capital standard, often referred to as ICS 2.0, as a part of its Common Framework for the Supervision of Internationally Active Insurance Groups.

In July 2018, the IAIS issued a consultative document proposing ICS 2.0, and several aspects of the proposal and process have caused serious concern in the United States insurance market. Among those concerns are, one, the proposed use of a market-adjusted valuation; two, the use of internal models; and three, a lack of clarity about the processing moving forward and how outcome equivalency will ultimately be determined.

ICS 2.0 is set to be implemented in two phases, including a 5-year monitoring period at the end of which IAIS will assess whether it considers the United States approach to be outcome equivalent.

There should be clarity about the path forward for further adjusting ICS 2.0 during the monitoring period as well as a better understanding of how outcome equivalency will be determined.

It is also important that ICS 2.0 be structured in a way that appropriately reflects the uniqueness of insurers and that works for U.S. insurers, including those operating abroad.

Treasury Secretary Mnuchin spoke earlier this year about ICS 2.0's development, where he highlighted three areas on which the Treasury is focused, including working to improve the design of ICS so it more appropriately reflects the unique business model of insurers, advocating for the IAIS to create a defined structure and process for further work and revision of ICS during the monitoring period, and ensuring that the final ICS is implementable in the United States.

Also, while speaking about the Federal Reserve's Building Blocks Approach to a risk-based insurance capital requirement, Federal Reserve Vice Chairman for Supervision, Randy Quarles, acknowledged the challenges of ICS 2.0 and potential consequences for consumers. He said:

> A capital standard that uses market-based valuation can introduce volatility and procyclicality, and one that is excessively volatile or procyclical can influence a firm to veer away from a long-term perspective and concentrate on the short term. This can have undesirable consequences, including diminishing product availability.

He also added about efforts at the IAIS on ICS 2.0: "In order for any form of an ICS to be implementable globally, it needs to be suitable for the U.S. insurance market. The current core proposal in the ICS would face implementation challenges in the United States."

While the IAIS has been working on its standard, the NAIC has worked on a Group Capital Calculation that is currently in field testing, and the Federal Reserve recently issued its proposed Building Blocks Approach.

Prior to a vote on ICS 2.0 and during the monitoring period, Team USA should leverage its work and progress on these U.S.-based standards to continue advocating for a more appropriate international standard and toward ultimately achieving outcome equivalency.

Furthermore, the Economic Growth, Regulatory Relief, and Consumer Protection Act calls for the Treasury and Federal Reserve, in consultation with the NAIC, to complete and submit to Congress a study on the impact on U.S. consumers and markets before supporting or consenting to the adoption of any final international ICS. I look forward to that update at the appropriate time.

Aside from a group capital standard, Team USA has also been engaged on several other projects at international forums, including a holistic framework for the mitigation of systemic risk, continued development of Insurance Core Principles, cyber resilience and big data, and governance, among others.

During this hearing, I look forward to receiving an update on Team USA's ongoing efforts to influence the development of ICS 2.0 so that it works for U.S. insurers, including those operating abroad, and our consumers, what aspects of group capital standards developed in the United States can help to improve ICS 2.0, changes that could be made to the ICS 2.0 development processes going forward to better understand opportunities to improve it and how to achieve outcome equivalency, and other key initiatives at international forums on which Team USA is actively working.

I appreciate, again, each of you joining us today and the work you have done to advance U.S. interests abroad.

Senator Brown.

OPENING STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman.

Welcome to all of you. Thanks for joining us.

Eleven years ago today, September 12, 2008, executives from AIG walked into the Federal Reserve Bank of New York to beg for a bailout. Supervisors at the Office of Thrift Supervision, whose leadership was so incompetent that OTS no longer exists, failed to identify risky transactions in AIG's Financial Products subsidiary in London. State regulators did not catch them either.

During the mortgage boom, AIG sold credit default swaps that allowed Wall Street banks to say that they were protected against losses from the toxic subprime mortgage securities that they owned. Some might even say they were insured. But AIG's failure would have taken down the banks it traded with, the biggest banks in the country. So AIG got a massive bailout, and—you guessed it—executives still got their bonuses.

Millions of Americans, on the other hand, lost their jobs, their homes, their retirement savings. The effects of the financial crisis incapacitated economies around the world and are still felt in many neighborhoods in my State.

Given the complexity and interconnectedness of the global financial system, it is critical for our regulators and our representatives at the Financial Stability Board and the International Association of Insurance Supervisors to work together to promote financial stability. I understand that we regulate insurance a little differently here in the United States. I support State-based insurance regulation. It allows U.S. insurers to serve small local markets as well as large international markets.

That need for some regulatory discretion is why I worked with Nebraska Republican Senator Johanns to pass a bill allowing the Fed to implement insurer-specific capital standards. It is also why I think it is important for our regulators to work with their international counterparts to make sure that our regulatory system is recognized and respected around the world.

Unfortunately, under the Trump administration, the Financial Stability Oversight Council, FSOC, no longer applies enhanced prudential standards or heightened supervision created under Dodd-Frank to even the largest insurance companies.

I can understand why international regulators might have the impression that we are not taking financial stability seriously in our country. We want international regulators to recognize our insurance regulatory system as credible. So it is imperative that our regulators recognize credible threats to financial stability.

The Administration must address emerging risks in the financial system. Instead, they are working to undermine the trust we regained by passing Wall Street reform. Some argue that a deregulatory race to the bottom is the only way for American insurance companies to be competitive. But the secret to America's success in financial markets is surely safety and soundness.

The United States has a long history of financial stability and independent regulation of our financial markets. That is why other countries trust our markets and our currency. I am concerned that this Administration has eroded the trust and is diminishing our leadership role in global financial regulation.

Today I hope to hear about how our regulators are working to curb financial risks at the largest insurance companies so that working families are not forced to bail them out again, and how they plan on restoring American leadership on these issues.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Brown.

We will now move to the testimony of our witnesses.

Mr. Seitz, you may begin.

STATEMENT OF STEVEN E. SEITZ, DIRECTOR, FEDERAL INSURANCE OFFICE, DEPARTMENT OF THE TREASURY

Mr. SEITZ. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify today about developments in global insurance regulatory and supervisory forums.

Among its statutory authorities, the Federal Insurance Office, or FIO, provides advice to the Treasury Secretary on major domestic and prudential international insurance issues. It represents the United States at the International Association of Insurance Supervisors and assists the Secretary in negotiating covered agreements. The FIO Director also serves as a nonvoting member of the Financial Stability Oversight Council.

As you know, the U.S. insurance sector plays a critical role in the U.S. economy. The United States has the largest and most diverse market in the world. Thousands of insurers operate in the United States, ranging from small mutual companies to large global firms operating across the world.

Turning to FIO's international engagement, as U.S. insurance companies compete globally and increasingly look overseas for growth opportunities, the Federal Government's participation in various international forums is crucial to ensuring that the U.S. insurance sector and our companies remain competitive internationally, and that international standards do not inappropriately affect the U.S. insurance companies operating here or the U.S. domestic insurance market.

It is important that the United States speak with the authority of a national government when addressing key international insurance matters during any international engagement.

Treasury and the Federal Insurance Office support the State-based system of insurance regulation, and we work closely with the U.S. States, the National Association of Insurance Commissioners, and the Federal Reserve Board.

As part of our collective advocacy, strong collaboration among all members of Team USA is critical to ensuring that the United States conveys a coordinated view in international discussions.

It is also important to note that international standards are not in and of themselves binding in the United States, unless they are adopted as law through domestic processes at either the Federal or State level.

However, as noted by the Secretary in his May remarks, as U.S. insurers expand into foreign markets, they will have to navigate the supervisory regimes of other jurisdictions that may be influenced by these standards.

I will now turn to some of the ongoing work at the IAIS. Last week, Treasury and the Federal Reserve issued a joint report to this Committee on our efforts in global insurance regulatory or supervisory forms. This report summarizes the work of the Federal Insurance Office at international standard-setting bodies.

First, I would like to briefly touch on our efforts to promote transparency at these bodies and then highlight two important initiatives—the insurance capital standard and the holistic framework.

As noted in our November 2018 joint report to this Committee, Treasury and the Federal Reserve support increased transparency and stakeholder input into IAIS decisionmaking. Domestically, Treasury routinely hosts meetings with U.S. stakeholders for open dialogue regarding the policy issues being discussed at the IAIS. Treasury and the Federal Insurance Office will continue to provide opportunities for U.S. stakeholders to engage with all members of Team USA on the issues arising before the IAIS.

Treasury appreciates and has contributed to the work of the IAIS on the insurance capital standard, and we support its overall objective of working to create a common language for supervisors around the world. However, we have concerns about certain aspects of ICS development, and we are working with our Team USA colleagues in pursuing constructive ways to address those concerns within the IAIS.

First, Treasury is working to improve the design of the insurance capital standard so that it more appropriately reflects the unique business model of insurers, particularly those that provide long-term savings products.

Second, Treasury believes it is important that the IAIS create a defined structure and process for further revisions and improvements to the ICS during the 5-year monitoring period from 2020 to 2024.

Third, it is important that the IAIS strengthen its efforts to develop a final insurance capital standard that can be implementable here in the United States.

Finally, getting the insurance capital standard right is more important than meeting any fixed schedule that mandates completion of this project at a specific point in time.

Another important initiative at the IAIS is the holistic framework for assessing and mitigating systemic risk in the insurance sector. 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 at the IAIS to develop improved standards for liquidity management and planning.

Thank you again for the opportunity to testify today, and I look forward to your questions.

Chairman CRAPO. Thank you, Mr. Seitz.

Mr. Sullivan.

STATEMENT OF THOMAS SULLIVAN, ASSOCIATE DIRECTOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. SULLIVAN. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for your time and the opportunity to testify today.

The Federal Reserve Board engages in insurance issues chiefly through its participation at the IAIS along with the Federal Insurance Office, the States, and the NAIC, and together, we act as Team USA and advocate for standards that are in the best interest of the United States.

The Fed regulates insurance holding companies that own federally insured depository institutions or firms that are designated by the FSOC. We leverage the work of the State insurance regulators wherever possible and continuously look for opportunities to coordinate with them.

The Fed also participates in insurance policy work streams as a member of the FSB. The FSB provides a framework for the work of the IAIS, but the responsibility for setting detailed standards for insurance rests with the IAIS.

In my testimony today, I would like to highlight and elaborate on a few items discussed in our joint report on international insurance engagement, as called for under S. 2155.

In 2013, the IAIS announced its plan to develop the international capital standard, or ICS. The ICS is intended to be a global risk-based capital standard that is fit for application for certain large international insurance groups.

Later this year, the IAIS plans to approve the ICS for a confidential use during a 5-year monitoring period. An international standard like the ICS could limit regulatory arbitrage and could help provide a level playing field for global insurers. It could also help to insure that U.S. companies are not held to bespoke or onerous regulations when they operate abroad.

There are concerns, however, that the ICS currently includes a valuation method and other requirements that may not be optimal for the U.S. Insurers that generally operate in a buy-and-hold, long-term approach to investing, yet the ICS currently uses a market-based valuation method whose volatility could ultimately reduce the availability of insurance products with long-term guarantees.

Because of these concerns, the board has proposed applying a building block approach, or the BBA, to insurers we supervise domestically rather than an ICS-type approach as currently designed. The BBA builds upon existing, well-known, State-based insurance standards to establish a group-wide minimum requirement.

Further, we support the NAIC's effort to develop a similar Group Capital Calculation, or as they call it, the GCC. We will continue to work with the NAIC to align these approaches to the greatest extent possible.

Through Team USA's efforts, we believe that we have created space in the international deliberations for the BBA and the GCC to be recognized as outcome-equivalent. The BBA can assist in our collective advocacy by demonstrating how an approach that leverages existing capital requirements can function and achieve the goals of the ICS.

Meanwhile, Team USA has continued to advocate for increasing transparency at the IAIS. For example, all significant policy proposals are now subject to at least a 60-day consultation period.

We have also advocated for obtaining stakeholder feedback much earlier on in the process. The development of the holistic framework is a good example of this. Three separate consultations have been conducted early on at the conceptual level, before the proposal became more granular. While this extensive engagement required more time, we would argue that the IAIS has benefited from it, and the stakeholder reaction thus far has been supportive.

The Fed has also worked to increase transparency at the FSB. Fed Vice Chair for Supervision Randal Quarles serves as the FSB Chair. He has made increasing FSB transparency and stakeholder engagement a key part of the group's agenda. In fact, as part of this, the FSB has also increased its direct engagement with insurers, including on the topic of the ICS.

Recently, the FSB and the IAIS held a joint stakeholder engagement event with representatives of large insurance groups.

Thank you for the opportunity to be with you this morning, and I will be happy to take your questions.

Chairman CRAPO. Thank you, Mr. Sullivan.

Mr. Cioppa.

STATEMENT OF ERIC A. CIOPPA, SUPERINTENDENT, MAINE BUREAU OF INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. CIOPPA. Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the invitation, and I am pleased to be here testifying alongside my Team USA colleagues.

Today I would like to focus my oral remarks on the IAIS's development of an insurance capital standard, or ICS. The NAIC has long contributed to the development of international insurance standards and adopted those that make sense for our market, but we have significant concerns with the direction and construction of the ICS.

The ICS remains not only technically flawed but also contrary to key policy initiatives in the United States, such as retirement security, long-term care, infrastructure investment, and disaster resiliency.

Rather than developing a truly global standard that has an appropriate level of flexibility, the ICS work to date largely reflects Europe's approach to regulation and would be unworkable for our system and harmful to the products our consumers rely on.

A regulatory standard that cannot be adopted by the world's largest jurisdictions does not create safer insurance markets globally and is not an international standard, regardless of the label applied to it.

Because the ICS is currently unworkable for our market, we are developing an aggregation method to group capital, which is different than the ICS, but that will provide comparable outcomes for the group-wide supervision of internationally active insurance groups. The IAIS has agreed to assess the aggregation method during the upcoming 5-year monitoring period.

The aggregation method is informed by our U.S. Group Capital Calculation and by the proposed Building Block Approach recently released by the Federal Reserve, but it has been designed to have utility for other markets as well. We believe that an aggregation method is not only comparable but superior to the current ICS as it provides more transparency into the capital structure and local risks within a group and uses less volatile accounting methods. The aggregation method will allow us to assess group capital and discuss related issues with our foreign counterparts but in a manner that will work with the U.S. regulatory framework and avoid the troubling aspects of the ICS.

We recognize that some large U.S. insurers who do business in other jurisdictions may have to comply with the ICS or ICS-like standards elsewhere. Consequently, in addition to developing the aggregation method, we are advocating for design changes to the ICS to lessen its deficiencies. However, even with such changes, the ICS remains fundamentally unfit for purpose in the U.S. market.

We are also working to develop and promote an approach to assessing the aggregation method so that by the conclusion of the monitoring period, it should be deemed a comparable jurisdictional alternative.

In the short term, between now and November, there are several meetings that will give Team USA the opportunity to further influence the discussions going forward. From our perspective, the IAIS should establish a definition of comparability that provides a viable path forward for the aggregation method and continue to improve the ICS.

The focus of comparability should be on whether regulators are empowered to take action on a group capital basis, and not a granular compliance exercise to a flawed ICS standard.

While we remain committed to engaging in the process, it is premature, if not irresponsible, to make more definitive commitments to a standard that presently all members of Team USA view as inherently flawed. Such a commitment would undermine the very point of a monitoring period, which should not be the conclusion of the ICS development but another opportunity to test it along with the aggregation method.

But let me also be clear. We will not be implementing the current ICS in the United States. States are moving forward with a Group Capital Calculation, and the Fed is moving forward with a Building Block Approach, both of which are compatible with the aggregation method. We believe this is the best path forward for U.S. consumers and market participants, while remaining consistent with the underlying purpose of the ICS.

In conclusion, the NAIC is committed to developing an appropriate approach for group capital for U.S. markets and continued engagement in international insurance standard setting alongside our Team USA colleagues with the primary objective of ensuring the United States remains the largest and strongest insurance market in the world.

Thank you for the opportunity to testify today, and I would be pleased to take your questions.

Chairman CRAPO. Thank you very much, Mr. Cioppa.

I will begin with the questions. First of all, I want to state to each of you, I appreciate the approach that Team USA is taking and the efforts to try to resolve this issue in a way that is beneficial to the U.S. markets.

Mr. Cioppa, the first question I have, I will refer to you, and that is, How is the IAIS-made U.S. representatives and other stakeholders aware of what outcome equivalency standards will be? In other words, how will the IAIS determine outcome equivalency, or have they engaged with us on that issue?

Mr. CIOPPA. Thank you, Senator, for that question.

I think today the guard lanes or guardrails, if you will, for comparability are murky, and I think we are pushing back and trying to work with the IAIS, that we think going into the monitoring period, it is critically important that we have definitions of comparability and principles upon which we can develop the continued development of the aggregation method. Today I think more work needs to be done, but we, the NAIC, along with other members of Team USA are pushing very hard for comparability guidelines going forward as we move into the monitoring period.

Chairman CRAPO. So, basically, we are not yet confident that we even understand how outcome equivalency will be determined?

Mr. CIOPPA. Correct. Again, we are making that a condition that has to be established and being more transparent and forthright going into the monitoring period about those issues of comparability.

Chairman CRAPO. All right. Thank you.

To Mr. Sullivan and Mr. Seitz, it seems to me that outcome equivalency is becoming a key factor here, and the fact that we will be focusing on trying to make sure that our approach in the United States is determined to be outcome equivalent is critical.

What aspects of the approaches to group capital under development in the United States are more appropriate for U.S. insurance market compared to ICS 2.0? In other words, what are these differences that we are trying to make sure are acceptable?

Mr. SULLIVAN. So, as you know, we released our proposal last week, which is a very detailed proposal, and it is foundationally built on an aggregation chassis. The BBS, as I talked about, leverages existing capital regimes, and so importantly, insurance products are very local. So by leveraging existing capital regimes in the Building Block Approach, we do not discriminate against the locality of where insurance products are underwritten. So we think that is a crucial tenet to what makes an aggregation approach work successfully.

As I pointed out in my opening remarks, the ICS, as currently designed, is built off the market valuation chassis, and that is detrimental to a long-term buy-and-hold approach.

Chairman CRAPO. Thank you.

Mr. Seitz?

Mr. SEITZ. I would just agree with Mr. Sullivan.

One of the main concerns that we have flagged with the ICS is the market-based valuation approach. It causes excessive volatility. It is not appropriately designed for the business model of insurers, and it does have the potential to significantly affect the ability of us to offer long-term guaranteed products here in the United States. And those products are critical to millions of Americans.

Chairman CRAPO. OK. All right. Thank you.

Then one last question that any of you can respond to, if you would like, and this is on big data.

On September 2, the IAIS issued a draft consultative document on the use of big data analytics in insurance, and the paper walks through sources of data used by insurers, including nontraditional data and supervisory considerations.

Their strategic plan also points to alternative data and fintech as a key strategic them over the next 5 years.

The NAIC has also done work on the issue of using alternative data by insurers and big data, and giving individuals more control over their data is a priority of mine at least and I think many on the Banking Committee here today.

Director Seitz, maybe I will focus this one to you and to Superintendent Cioppa. How is the use of alternative data shaping the insurance marketplace in the United States and abroad? And I apologize. You each only have about 20 seconds to answer that.

Mr. SEITZ. We are aware of the important issue and have been working with the IAIS on that paper.

We are also looking into these issues as part of our insurtech work at the Federal Insurance Office, and we plan to summarize the landscape of these issues in our upcoming annual report.

Chairman CRAPO. Thank you.

Mr. Cioppa?

Mr. CIOPPA. Yes. Big data is one of the current top priorities for the NAIC. We recognize the significance and the implications for consumers and for companies as they utilize big data, and it is important to point out that one of the rating—the rating laws in every State say rates cannot be unfairly discriminatory, and there are certainly implications for that in the utilization of big data. So that is, as I said, one of our priorities.

Chairman CRAPO. All right. I appreciate your attention to this, and as I am sure you know, we have a strong concern about consumer privacy and the management and utilization of big data. So thank you for that attention.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

This is a question for all three of you, and I would prefer you to answer yes or no, if you can.

Do you agree with FSOC that there are no insurance companies in the United States whose material financial distress could pose risk to the broader economy?

Mr. Seitz?

Mr. SEITZ. We support the move that the FSOC has made toward the activities-based approach, and that guidance is currently under proposal. And the FSOC is currently taking back stakeholder feedback.

Senator BROWN. Mr. Sullivan, did FSOC make the right decision in their de-designation? Same question.

Mr. SULLIVAN. Yes, I believe they had, and Chairman Powell has voted as such.

Chairman CRAPO. Mr. Cioppa?

Mr. CIOPPA. Yes. I also believe they have. I mean, I think the activities-based approach is a much more appropriate approach to insurance risk.

Senator BROWN. I am not surprised at your answer. I kind of expected that answer, but I think it identifies the problems that we are not using the tools—that you are not using the tools we gave you to combat systemic risk.

Let me go somewhere else. Let us focus on the vast majority of U.S. insurance companies whose business is mostly domestic.

Mr. Sullivan, a moment ago in response to Chairman Crapo, you said insurance products are very local. So each of you again, I will start with you, Mr. Cioppa, and go this way this time.

Do you think FSOC's failure to regulate the largest international insurance companies has made foreign regulators less sympathetic to our smaller domestic insurers?

Mr. CIOPPA. I do not know if they made it less sympathetic to our smaller domestic insurers, but I think Europe fundamentally does not understand our system.

I mean, we do a lot at the group level in regulating insurers, including insurers like AIG. At the group level, I think they—they being Europe—need to focus on. We also do a lot with Own Risk and Solvency Assessment (ORSA). We do enterprise risk management. We have got a whole host in our toolkit that we are utilizing, and I think effectively, to regulate these large multinational companies, and I think it is more a case of Europe needs to become more aware of that fact.

Senator BROWN. Well, saying that Europe—you did not quite say it this way, but Europe is too stupid to understand how we do things does not exactly open the avenues of—I mean, do they—well, I will just leave it at that, Mr. Sullivan, and give your answer, if you would.

Mr. SULLIVAN. So I would align myself with Superintendent Cioppa's remarks.

I would also add that the U.S. insurance markets is as robust as it has ever been. There is a high level of competition in our insurance market, and it is quite healthy.

And, also, some of the larger insurers who you would have looked at as being more risky have gone through quite a large degree of de-risking over time.

Senator BROWN. I will get to you in a second.

So did de-designation send a message or did it not send a message to European regulators?

Mr. SULLIVAN. There is much more discipline today in how insurers behave.

I will give you an example. No one is writing variable annuities with the kind of untethered risk that they used to write pre-crisis. So I believe there has been a good degree of de-risking of most large insurers, but from the risk they are underwriting and from how they manage their own risk internally with their assets and other——

Senator BROWN. That is a good answer, but it was not an answer to did de-designation send a message to European regulators.

Mr. Seitz?

Mr. SEITZ. The IAIS and the FSB are also moving toward the holistic framework, which is an activities-based approach that is consistent with the work that is being done here domestically at the Financial Stability Oversight Council. Both of those projects are substantively in the same direction.

And, additionally, the NAIC has been making steps through its Macro Prudential Initiative to deal with these issues related to macro prudential issues such as surveillance and liquidity management and planning.

Senator BROWN. One last question for the three of you. IAIS has identified climate change as an emerging risk to stability in insurance markets. We have seen staggering losses. The Bahamas, I do not know what the cost of that is, but tragic and huge; estimated $125 billion in the Houston area, flooding from Hurricane Harvey; $96 billion devastation in Puerto Rico from Hurricane Maria.

In 2016 alone, you know what has happened with agriculture and fires. Ohio farmers, most Ohio farmers, did not even get 50 percent of their corn and soybeans in. You cannot always attribute every single thing, obviously, to climate, but insurance companies are certainly recognizing this risk.

What are Federal and State regulators doing to address the impact of climate change on insurance companies?

Mr. Seitz?

Mr. SEITZ. We are working with FEMA on a variety of issues related to mitigation. We are part of the team that put out, under FEMA's leadership, the National Mitigation Investment Strategy, which was issued last month. We are also working on these issues from our Federal Advisory Committee on Insurance, they are particularly looking at what the insurance sector can do to help bridge the protection gap between the economic losses of disaster and then the insured losses.

Senator BROWN. Mr. Sullivan?

Mr. SULLIVAN. We only currently supervise eight insurers. The largest part of the market is supervised by Superintendent Cioppa and his colleagues at the NAIC. So the firms that we do supervise, we do not dive deep into how they are looking at climate risk and how they are responding to natural catastrophes. We accept the work of the State insurance supervisors.

Senator BROWN. OK. Mr. Cioppa?

Mr. CIOPPA. Senator, climate risk is another top issue we are dealing with. Obviously, it is a significant issue and it is worth noting the last few losses have been significant, if not unprecedented, but insurers have, by and large, paid the bills they promised policyholders. That is a testament to the strength of the industry.

But at the NAIC, we have developed capital charges for catastrophe losses, and when we do our examination, making sure the board of directors is completely engaged in their risk management program planning for a climate risk and climate change as it relates to their ability to meet their obligations to policyholders.

Senator BROWN. Thank you.

I will close, Mr. Chairman. You all were either Trump nominees or you work for people who are Trump nominees. I hope that you can get that message.

You do not. I am sorry, Mr. Cioppa. So I guess two out of three. Sorry.

But your work is so important. I hope you can get that message to the Administration about climate and what is happening.

Thank you.

Chairman CRAPO. Thank you.

Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman, and thank you to the witnesses for joining us today.

My understanding is that during the November IAIS meeting in Abu Dhabi, the ICS is likely to be approved and, thus, begins the monitoring period.

Yet each of the witnesses today have identified specific concerns with the ICS as it is currently drafted.

So my question, I guess, is kind of a process question. To the extent that your concerns are not adequately addressed prior to Abu Dhabi, what does Team USA do to make sure that the IAIS does address the concerns and fix these problems during that subsequent monitoring period?

Whoever would like to address that, it would be welcome.

Mr. Seitz?

Mr. SEITZ. It is critical that the ICS work for our markets here, and this will be a focus of our attention in the upcoming meetings over the next few months. And we are going to push the IAIS hard to make sure that the monitoring period is recognized as a milestone but is not the end of the game, and that the process will continue over the next 5 years to not only fix the current flaws in the reference to ICS, but also to continue the important work so that our U.S. system is deemed comparable.

Senator TOOMEY. Mr. Sullivan?

Mr. SULLIVAN. I would agree that November, while a significant milestone, is not the end of the road. We are going to continue to push and advocate hard to get what we need to be responsive to the U.S. market, but I do not think November should be looked at as kind of a drop-dead.

Senator TOOMEY. OK. Mr. Cioppa, did you want to add anything?

Mr. CIOPPA. No. I agree. Again, it is critical that we stay engaged, and it is critical we keep pressing the point that the current construct of the ICS does not work for our system. But, at the same time, to repeat myself, we have to stay engaged in the process.

Senator TOOMEY. Each of your testimonies suggest that there are specific products that are very common, very popular in the United States, that could be jeopardized by the current framework, and that would include life insurance and annuities, right? They are very, very standard, common practice.

So could you get into a little bit of detail on what specifically needs to change in the ICS proposal so that we do not undermine these products that serve so many of our constituents?

Mr. Seitz?

Mr. SEITZ. Those products that you mentioned are critical to millions of Americans, adding retirement, and our team is working with the Team USA colleagues to evaluate the data that firms are voluntarily setting up to make sure that the discount rates and other technical issues are appropriately designed so that it reflects those products.

Chairman CRAPO. Mr. Sullivan?

Mr. SULLIVAN. There are a number of technical—I would not even call them nuances, because they are substantial, but when taken together, they do show a gaping hole in the design of the ICS.

I would say, fundamentally, the biggest one is the market-based valuation which, again, takes risk and puts it in a 1-year prism, when insurers are underwriting annuities and life products that have a 30-, 40-year duration.

Senator TOOMEY. Specifically, just so I understand, we are talking about the methodology of valuing the assets insurance companies old to generate the income to pay the policyholders?

Mr. SULLIVAN. That is right. They match their insurance liabilities with assets that have a similar duration, and if you create noise that disrupts that, we fear that it will affect product offerings.

Senator TOOMEY. Kind of undermines the fundamental model of a long-term asset serving the long-term liability.

Mr. Cioppa, did you want to add anything on that?

Mr. CIOPPA. I absolutely agree it is critical, and insurers are able to match their assets to the liabilities in a prudent fashion, and the current construct seems to inhibit that.

I am hearing over in some markets, insurers are actually abandoning those products.

Senator TOOMEY. I have heard a characterization of the comparison between the regulatory and specifically capital approach in Europe versus the United States that I wonder if you would agree with. Roughly speaking, the characterization was that the U.S. model tends to emphasize and prioritize ensuring that insurance companies can honor their commitments to policyholders, and it is the survivability of the policy that is the primary focus.

Whereas, in Europe, there is greater emphasis on the survivability of the firm as a whole, and that is the mechanism by which they hope to insure the policyholder. Is that a fair characterization of the difference between our regulatory approaches? Anybody?

Mr. CIOPPA. I can start. At least as for the U.S. system, we do have a base of accounting called statutory base of accounting, which is a liquidation-based accounting, which, in other words, we do not allow intangible assets to be counted as assets like deferred acquisition costs strictly for that reason, to make sure an insurer can pay, because you cannot pay claims with those assets.

Senator TOOMEY. Exactly right.

Mr. CIOPPA. So it is very firmly based in protecting policy holders, and in Europe, it seems to be more keeping the entity alive at a higher level, at the holding-company level.

Senator TOOMEY. Mr. Sullivan?

Mr. SULLIVAN. Senator Toomey, I would say there is another dimension too. I mentioned earlier how insurance products are quite local. If your market does not have a need for annuity products, for instance, because there are robust government pensions, then you will likely design your regulatory regime to not be sensitive to those types of products. Whereas, we need those here. So we need a regulatory regime, which is reflective and responsive to the types of risks that our insurance underwriters are taking.

Senator TOOMEY. Mr. Seitz?

Mr. SEITZ. I would just agree with the comments by Superintendent Cioppa and Mr. Sullivan.

Senator TOOMEY. Great. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman. Thank you to the witnesses.

If ICS Version 2.0 is adopted in November, a 5-year monitoring or field testing period will start next year. The IAIS has indicated that it is open to possible clarification and refinements of major flaws or unintended consequences identified with the ICS during the monitoring period.

To all of our witnesses, what actions are expected to result from this 5-year monitoring period? We can just go down the line.

Mr. SEITZ. Thank you, Senator.

That will be one of the main topics of discussion in the upcoming meetings. I think our view at FIO is that the monitoring period needs to be structured in a way such that it allows for continued transparent involvement of U.S. insurers and the IAIS on improving those design flaws and making sure that the ICS is not fixed in place by November but can continue to evolve as it needs to over the next 5 years.

Mr. SULLIVAN. Senator, while we support the utility of group capital, because we do think that looking at capital through a prism of just legal entities has some risks, we are not going to sign on to ICS if it is fundamentally poorly designed or flawed, and that is why, as Director Seitz pointed out, we will continue to push for changes so that it is properly designed and calibrated.

Mr. CIOPPA. I would only add, Senator, I agree with their comments, but it is also critically important during the monitoring period that the IAIS communicates what the ICS is not during the monitoring period. It is not a capital standard in which a regulator will take action on and then could be used inappropriately by rating agencies or banks to judge the financial strength of what we feel is a flawed capital standard. I think that is an important element in the monitoring period as well as that communication to ensure that is communicated to the broader audience at large.

Senator MENENDEZ. If your IAIS counterparts have different expectations, how should Team USA go about resolving differences and expectations?

Mr. SULLIVAN. I would just say that is the ebb and flow of kind of international dialogue.

I think we, the United States, have a big stake in this, since we are the world's largest insurance market. I do not think a standard produced by the IIS which ignores the United States is going to be viewed as an international standard if it disrespects the world's largest insurance market.

Senator MENENDEZ. Any other remarks?

Mr. SEITZ. I would just agree with Mr. Sullivan. I mean, I think all of us at the panel are in alignment on the importance of this issue and will continue to push it with our international counterparts.

Senator MENENDEZ. How are the IAIS and FSB planning to design and implement the impact analysis to ensure that it will be conducted in a credible and independent manner, and what are each of your agencies doing to ensure that such analysis is undertaken?

Mr. SULLIVAN. Sure. I mentioned in my opening remarks how Vice Chair Quarles and the current Chair of the FSB held a joint stakeholder meeting with members of the IAIS, the FSB, and interested parties. That was really a first in terms of beginning the process to listen to the stakeholders about that and to get after doing exactly what you said in your question. So we are in an early stage, I would say.

Senator MENENDEZ. OK.

Mr. SEITZ. It is also an issue that we are discussing at our Federal Advisory Committee on Insurance. We have an international subcommittee, and it has been one of the issues that has been raised there. And we are looking into it.

Senator MENENDEZ. During the monitoring period, all internationally active insurance groups are subject to confidential reporting, and it is important to keep this reporting exactly that, confidential. While the IAIS has taken some initial steps to explicitly state that the monitoring period is confidential to prevent third parties like debt underwriters and rating agencies from seeking data, companies continue to tell us that more assurances are needed.

How will each of you advocate in the IAIS to keep company results reported during this 5-year period confidential? What else is Team USA doing to protect the release of this data?

Mr. CIOPPA. Again, Senator, that relates to my prior comment. Again, I think it is critically important we continue to press for the IAIS to make public statements, what this is and what it is not, and again, it is during a monitoring period. It is not a prescribed capital requirement at this point in time, and you cannot stress that enough. If a number gets out, that it could cause material harm to companies. So I think it is incumbent upon us, each individual and as Team USA to continue to press that.

Senator MENENDEZ. Finally, Director Seitz, if we were to remove U.S. representatives from international organizations on insurance standards, would those standards look more like EU standards or American standards?

Mr. SEITZ. We are committed to continued engagement in the international process. It is important that we engage because our U.S. companies want to compete internationally, and it is critical that we are there to help that happen as well and also because we do not want inappropriate standards to come back and affect our U.S. insurance market.

Senator MENENDEZ. Right. So if the United States is not at the negotiating table, international insurance standards will be written without us, and I think it is important to remember that these conversations continue. The United States needs to have a seat at the table in order to effectively shape international standards to match the strong standards that we have here in the United States.

We look forward to your work.

Thank you very much, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman.

This hearing could not come at a more critical time for our insurance regulatory system. The International Association of Insurance Supervisors, or IAIS, is weeks away from convening a meeting of international insurance regulators in Abu Dhabi that will involve voting on a framework for assessing global insurance capital standards known as the ICS.

In May, I led a letter from 42 Senators to Governor Quarles at the Federal Reserve raising a number of concerns about the ICS. I would like to ask unanimous consent that my letter, the response from Governor Quarles, and a statement expressing similar concerns from the American Council of Life Insurers be entered into the record.

Chairman CRAPO. Without objection.

Senator ROUNDS. Thank you, Mr. Chairman.

We should not kid ourselves as to what is really going on here. It is increasingly clear that the European Union is using the ICS as a means of forcing the EU's Solvency II framework on the rest of the world.

In a letter to its regulators dated August 26th, the European insurance industry said that an allowance for internal calculation models, common among European insurers and recognized in the Solvency II, should be a permanent and integral part of the ICS.

I would like to ask unanimous consent that this letter also be entered into the record.

Chairman CRAPO. Without objection.

Senator ROUNDS. THANK YOU, MR. CHAIRMAN.

I would also like to take a moment to thank my good friend and the Ranking Member for comments that he has offered at similar hearings in 2017. During that hearing, Senator Brown said that the State-based insurance system is unique and—I quote him—"We should fight to maintain it, including by rejecting efforts to impose the Solvency II accord, Europe's insurance capital rules on our insurers," end of quote.

We may not agree on GSE, sir, but I think we have agreement on this one.

Finally, to our European friends, we treasure our relationship, but it is unacceptable for the European Union to promote its regulatory framework at the expense of another. As my letter from May demonstrated, without a recognition of the U.S. State-based insurance regulatory system, the ICS will become a political problem.

I have got just a couple of questions that I would like to lead into and then a few concluding remarks.

Gentlemen, I have made it clear that an ICS that does not guarantee an explicit mutual recognition of the American aggregation method would be unacceptable. If the IAIS proceeds with an ICS that does not guarantee recognition of the aggregation method, will you vote no at the IAIS meeting in November?

I just want to go down the line. Commissioner Cioppa?

Mr. CIOPPA. I think it is vitally important we stay engaged, and to be clear, we are not going to adopt an ICS that does not work for our system, period. I mean, that is the position of the NAIC.

But I think it is a little premature to say we would vote no in November. I think the guardrails need to be established. The comparability definition needs to be established, and we need to ensure that.

Senator ROUNDS. Mr. Thomas?

Mr. SULLIVAN. So I would agree with the superintendent. There is a lot to be done between now and November.

Senator ROUNDS. Excuse me. Mr. Sullivan. I apologize.

Mr. SULLIVAN. That is OK.

To the earlier question directed to Director Seitz, disengagement is not going to help anyone.

Senator ROUNDS. Director Seitz?

Mr. SEITZ. I would just agree that all of us at the table are going to advocate strongly for U.S. interests and continue the work to make sure that the ICS works for our system.

Senator ROUNDS. In each particular case, if we move forward and we do not make it very clear that at the international level, there has to be an allowance for the way that our companies do business, then I think this becomes a failure.

And the one thing we do not want to do is to have a failure on our hands in this particular case, but there has to be a recognition. If they simply seem to move forward and allow us to kick this can down the road without making it very clear, then I think we failed in this particular case. Would that be a fair statement?

Mr. CIOPPA. Well, I think we need to make it clear, and I think we are making it clear. And I want to thank the Senator for this hearing because I think this helps make it clear. We are not going to adopt something that harms our consumers and our companies, and I think that message is starting to resonate loud and clear.

As Director Sullivan said, we are the largest insurance jurisdiction in the world, and you cannot have, in my opinion, a truly international capital standard that ignores the largest jurisdiction in the world.

Senator ROUNDS. Would you have agreement with his statement, gentlemen? I see nods.

Well, Mr. Chairman, as I wrap up, I just want to make a point that the United States has already established a bilateral deal with the European Union on insurance standards in the U.S.–EU covered agreement on insurance and reinsurance. That agreement guaranteed mutual recognition of each of our systems of insurance regulation. So it seems that it would be inconsistent of the European Union to expect anything different with the ICS.

In addition, I would strongly urge Team USA to vote no at the IAIS meeting in Abu Dhabi this November if the ICS does not guarantee a mutual recognition of the American aggregation method. I think anything less than that type of an assurance is simply not appropriate for the insurers and the business community here within the United States.

Mr. Chairman, I thank you, and I yield back.

Chairman CRAPO. Thank you.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman, and thank you to the panel for being here this morning.

Like Senator Rounds, I spent a fair amount of time in the insurance industry and love the concept of protecting a State-regulated system that has been the marvel of the world, and I think will continue to do so as long as Team USA sings with one voice.

I heard, Mr. Cioppa, your comments about the question of how you would vote in November, but I did not really hear a no, that you would vote no. In as few words as possible, which would be like a no or a yes, can you confirm to me what I heard you say which is it would be unacceptable? Therefore, my assumption is if something is unacceptable, that the only vote would be no. Am I correct in assuming that if it is, indeed, unacceptable that your vote would be no? And if it is not no, tell me why it is not no, because what you said is it is unacceptable, and if something is unacceptable, then the answer should be no.

Mr. CIOPPA. I will try to do this in as few words as possible.

Senator SCOTT. You could just say, "Then I would vote no."

[Laughter.]

Mr. CIOPPA. Well, it really is about two things. One, a lot is going to happen between here and November. There are several meetings, but more importantly, that 5-year monitoring period, a lot could change during the monitoring period. And I think if there is a viable path forward, I think we seriously have to consider going along, but we have to stay engaged. That is a needle we have to thread. By voting no, do we disengage prematurely?

Senator SCOTT. If you are not voting no, do you abstain?

Mr. CIOPPA. It could be any along the spectrum, but again, all the time making it clear, the current construct is just not going to work for us. And at the end of the day, you cannot put lipstick on a pig if they do not change the pig.

Senator SCOTT. Yes. I still did not hear no or at least an abstention.

I am going to ask the same question to everyone, because if I cannot have great confidence in the fact that you guys are voting no as Team USA—and, in fact, everything I have heard so far this morning, I had questions I wanted to ask, but you guys have done such a good job of answering the question before I have had a chance to ask the question. The only question that I have left really is to clarify the few things that I do not fully understand because you have said already that equivalency and protecting our system is paramount.

You have said that because we are 40 percent of the market, we should have an outsized position. You have inferred in your comments that, ultimately, not being at the table, it almost pains me to quote and suggest that Senator Brown has good ideas, but he really does this time around. It is painful, but I have to agree with him that protecting the American model—and Senator Menendez said that being at the table helps us protect that American model, and if we are at the table, but yet we are not making progress with the ICS, then it tells me that being at the table is not enough. That, in fact, we should do something that sends a clear signal that protecting our insurance market and frankly protecting the policyholders who—I used to sell annuities. I am sure, Senator Rounds, you sold annuities. Frankly, to have the liability exposure covered requires us to have a long-term view that is inconsistent with the international model because they have such a defined benefit concept that the defined contribution concept does not become invoked. Therefore, in order for us to protect those who are planning for their own retirement, we have to have a very different system.

But when I look at the results of the international body, we seem to be not gaining ground in that area. So that is why for me, while November 20th may not be the drop-dead date, but it is, in fact, a very important marker—and I am hoping that if I am voting yes for the three candidates that I am going to have a no or an abstention when it comes time to protect our system, if that is what it takes.

Maybe it does not take that, but I need the confidence that the system has to be protected against all odds, or I should rethink my commitment to those folks who are going to represent Team USA.

So I want to be that clear that in order for me to be in a very comfortable position moving forward—and I think this Committee should embrace and adopt that concept that it is that important for Team USA to speak with one voice from one page consistently in a world where we are 40 percent of the market, and our system protects our policyholders from something that other folks do not have to be protected from—I want to know that we are as close to a no or an abstention as possible.

Mr. Sullivan?

Mr. SULLIVAN. So your words are very encouraging, Senator Scott. I think I would say that, directionally, we are there, but there is nuance in the give-and-take of international dialogue. We do not want to disengage, but we are also not going to accept a bad deal.

Senator SCOTT. So if it is a bad deal, is that a no or an abstention? Am I accurate in assuming that?

Mr. SULLIVAN. We have to see what is in front of us, come November.

Senator SCOTT. OK. Maybe I am voting no for him.

Mr. Seitz?

Mr. SEITZ. We are going to advocate strongly for U.S. interests. All three of us at the table are very committed to that process, and at this stage, the questions on the ICS are not a binary question. But we are going to continue to push our international colleagues over the next few months for progress on these important areas.

Senator SCOTT. I just want to make sure I understand this correctly. So pushing for advocating, on behalf of, having the need to protect, I have to vote—believe it or not, Senators actually vote more than most Americans may think. I am surprised that we are actually voting as much as we are, but this is a good thing. And we are having to make decisions about future votes, and I know that when my constituents ask me a question about protecting their assets, they want to know that, except for a catastrophic occurrence, exactly what I tell them is exactly what I am going to do. And I think this is an easy one to say no or an abstention to, from my perspective.

Thank you.

Chairman CRAPO. Thank you.

Senator McSally.

Senator MCSALLY. Thank you, Mr. Chairman.

Well, I want to join my colleagues to reinforce the importance of advocating for international recognition of the United States approach to insurance regulation. Our system of State-based regulation works, and it protects consumers and gives companies accountable regulator.

My time serving abroad in uniform solidified my commitment for U.S. sovereignty. Working with many partners and coalitions, those are fine, but the importance, to make sure that international rules work the way that the United States does things.

International agreements can be great when they help protect our interests is the bottom line. Our insurance regulatory system does work here and has worked here for a long time. So let us not allow some international body to force us to put into place something that does not work, and I think you have heard a lot about that today.

It is vital that our representatives of these international bodies do everything they can to protect U.S. interests. So that means U.S. approaches to insurance regulation are recognized internationally.

So I am just asking a commitment for me that each of you personally, you will do everything you can to make sure that standards are put in place by the International Association of Insurance Supervisors that are working for the United States and are recognizing the U.S. approach.

Mr. SULLIVAN. I am fully committed to that.

Mr. CIOPPA. Completely committed to that.

Senator MCSALLY. OK.

Mr. SEITZ. Same here.

Senator MCSALLY. All right. Thank you.

Thank you, Mr. Chairman. Yield back.

Chairman CRAPO. All right. Thank you very much.

That concludes the questioning for this hearing. I again want to thank each of our witnesses for not only being here today but for your advocacy for the interest of the United States in this process.

I think you got a very clear message that there is bipartisan support on this Committee for that strong advocacy to protect the U.S. interest in this decision.

With that, I would like to announce to our Senators, those who wish to submit further questions for the record, that those questions are due to the Committee by Thursday, September 19th. We ask that you respond to these questions as quickly as you can when you receive them.

Again, I thank each of you for being here today.

This hearing is adjourned.

[Whereupon, at 11:05 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follows:]

PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO

Today, we welcome to the Committee the three members of "Team USA" representing the United States in international insurance supervisory and regulatory forums, including: Steven Seitz, Director of the Federal Insurance Office in the Treasury Department; Thomas Sullivan, Associate Director at the Board of Governors of the Federal Reserve System; and Eric Cioppa, Superintendent of the Maine Bureau of Insurance, on behalf of the National Association of Insurance Commissioners.

On September 6, 2019, the Treasury and Federal Reserve issued its annual report regarding their efforts, with the National Association of Insurance Commissioners (NAIC), in international forums, such as the International Association of Insurance Supervisors (IAIS).

The report, and accompanying testimony, are required by the Economic Growth, Regulatory Relief and Consumer Protection Act, to encourage greater transparency into, and reinforce a unified approach to efforts by "Team USA" at those international forums.

A key driver of this provision is the IAIS's multi-year effort to develop a group-wide, risk-based insurance capital standard, often referred to as ICS 2.0, as a part of its Common Framework for the Supervision of Internationally Active Insurance Groups.

In July 2018, the IAIS issued a consultative document proposing ICS 2.0, and several aspects of the proposal and process have caused serious concern in the U.S. insurance market. Among those concerns are: the proposed use of a market-adjusted valuation; use of internal models; and a lack of clarity about the processing moving forward and how outcome equivalency will ultimately be determined.

ICS 2.0 is set to be implemented in two phases, including a 5-year "monitoring period," at the end of which the IAIS will assess whether it considers the U.S. approach to be "outcome equivalent."

There should be clarity about the path forward for further adjusting ICS 2.0 during the monitoring period, as well as a better understanding of how outcome equivalency will be determined.

It is important that ICS 2.0 be structured in a way that appropriately reflects the uniqueness of insurers and that works for U.S. insurers, including those operating abroad.

Treasury Secretary Mnuchin spoke earlier this year about ICS 2.0's development, where he highlighted three areas on which the Treasury is focused, including: working to improve the design of ICS so it more appropriately reflects the unique business model of insurers; advocating for the IAIS to create a defined structure and process for further work and revision of ICS during the monitoring period; and ensuring that the final ICS is implementable in the United States.

Also, while speaking about the Federal Reserve's "Building Blocks Approach" to a risk-based insurance capital requirement, Federal Reserve Vice Chairman for Supervision Randy Quarles acknowledged the challenges of ICS 2.0 and potential consequences for consumers.

He said, "A capital standard that uses market-based valuation can introduce volatility and procyclicality, and one that is excessively volatile or procyclical can influence a firm to veer away from a long-term perspective and concentrate instead on the short term. This can have undesirable consequences, including diminishing product availability."

He also added about efforts at the IAIS on ICS 2.0, In order for any form of an ICS to be implementable globally, it needs to be suitable for the U.S. insurance market. The current core proposal in the ICS would face implementation challenges in the United States.

While the IAIS has been working on its standard, the NAIC has worked on a Group Capital Calculation that is currently in field testing and the Federal Reserve recently issued its proposed "Building Blocks Approach."

Prior to a vote on ICS 2.0 and during the monitoring period, "Team USA" should leverage its work and progress on these U.S.-based standards to continue advocating for a more appropriate international standard and toward ultimately achieving outcome equivalency.

Furthermore, the Economic Growth, Regulatory Relief, and Consumer Protection Act calls for the Treasury and Federal Reserve, in consultation with the NAIC, to complete and submit to Congress a study on the impact on U.S. consumers and markets before supporting or consenting to the adoption of any final international ICS. I look forward to that update at the appropriate time.

Aside from a group capital standard, "Team USA" has also been engaged on several other projects at international forums, including a holistic framework for the mitigation of systemic risk; continued development of Insurance Core Principles; cyber resilience and big data; and governance, among others.

During this hearing, I look forward to receiving an update on "Team USA's" ongoing efforts to influence the development of ICS 2.0 so that it works for U.S. insurers, including those operating abroad, and consumers; what aspects of group capital standards developed in the United States can help to improve ICS 2.0; changes that could be made to the ICS 2.0 development process going forward to better understand opportunities to improve ICS 2.0 and how to achieve outcome equivalency; and other key initiatives at international forums on which "Team USA" is actively working.

I appreciate each of you joining us today and the work you have done to advance U.S. interests abroad.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

Eleven years ago today, September 12, 2008, executives from AIG walked into the Federal Reserve Bank of New York to beg for a bailout.

Supervisors at the Office of Thrift supervision, whose leadership was so incompetent it doesn't exist anymore, failed to identify risky transactions at AIG's "Financial Products" subsidiary in London. State regulators didn't catch them either.

During the mortgage boom, AIG sold Credit Default Swaps that allowed Wall Street banks to say that they were protected against losses from the toxic subprime mortgage securities they owned. Some might even say they were "insured." But, AIG's failure would have taken down the banks it traded with—the biggest banks in the country. So, AIG got a massive bailout. And, you guessed it, the executives still got their bonuses.

Millions of Americans, on the other hand, lost their jobs, their homes, and their retirement savings. The effects of the financial crisis incapacitated economies around the world.

Given the complexity and interconnectedness of the global financial system, I think it is critical for our regulators and our representatives at the Financial Stability Board and the International Association of Insurance Supervisors to work together to promote financial stability.

I understand that we regulate insurance a little differently here in the United States, and I support State-based insurance regulation. It allows U.S. insurers to serve small, local markets as well as large, international markets. That need for some regulatory discretion is why I worked with Republican Senator Johanns to pass a bill allowing the Fed to implement insurer-specific capital standards. That's also why I think it's important for our regulators to work with their international counterparts to make sure our regulatory system is recognized and respected around the world.

Unfortunately, under the Trump administration, the Financial Stability Oversight Council no longer applies enhanced prudential standards or heightened supervision created under the Dodd-Frank Act to even the largest insurance companies. I can understand why international regulators might have the impression that we are not taking financial stability seriously here at home.

We want international regulators to recognize our insurance regulatory system as credible. So it is imperative that our regulators recognize credible threats to financial stability.

This Administration must address emerging risks in the financial system. Instead, they are working to undermine the trust we regained by passing Wall Street Reform.

Some argue that a deregulatory race to the bottom is the only way for American insurance companies to be competitive. But the secret to America's success in financial markets is safety and soundness. The United States has a long history of financial stability and independent regulation of our financial markets. That's why other countries trust our markets and our currency. I am concerned that this Administration has eroded that trust and is diminishing our leadership role in global financial regulation.

Today, I hope to hear about how our regulators are working to curb financial risks at the largest insurance companies so that working families aren't forced to bail them out again, and how they plan on restoring American leadership on these issues.

I thank the Chairman for holding this hearing, and the witnesses for their testimony today.

PREPARED STATEMENT OF STEVEN E. SEITZ

DIRECTOR, FEDERAL INSURANCE OFFICE, DEPARTMENT OF THE TREASURY

SEPTEMBER 12, 2019

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for the opportunity to testify today about developments in global insurance regulatory and supervisory forums. My name is Steven Seitz, and I am the Director of the Federal Insurance Office (FIO) within the U.S. Department of the Treasury (Treasury).

FIO serves as a source of insurance expertise in the Federal Government. Among its other statutory authorities and responsibilities, FIO: provides advice to the Treasury Secretary on major domestic and prudential international insurance policy issues; represents the United States at the International Association of Insurance Supervisors (IAIS); assists the Treasury Secretary (together with the U.S. Trade Representative) in negotiating covered agreements; consults with the States regarding insurance matters of national importance and prudential insurance matters of international importance; assists the Treasury Secretary in administering the Terrorism Risk Insurance Program; and monitors the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis. The FIO Director also serves as a nonvoting member of the Financial Stability Oversight Council.

As you know, the U.S. insurance sector plays a critical role in the U.S. economy. The United States has the largest and most diverse insurance market in the world. U.S. insurance premiums were over $2 trillion in 2018, an amount that exceeds 10 percent of the U.S. gross domestic product. Thousands of insurers operate in the United States, ranging from small mutual companies operating in a single county to large global firms operating across the world.

Additionally, insurers throughout the world are interested in offering insurance products in the United States, which speaks to both the attractiveness of our insurance market and the benefits of the geographic spreading of risk.

International Supervisory Forums

Turning to FIO's international engagement, as U.S. insurance companies compete globally and increasingly look overseas for growth opportunities, the Federal Government's participation in various international forums is crucial to ensuring the U.S. insurance sector and our companies remain internationally competitive. Additionally, the Federal Government's participation is crucial to ensuring that international standards do not inappropriately affect U.S. insurance companies or the U.S. domestic insurance market. It is important that the United States speak with the authority of the national government when addressing key international insurance matters during any international engagement. In so doing, it is equally important that FIO coordinates with our State colleagues, who are the primary regulators of the business of insurance in the United States. Treasury and FIO support the State-based system of insurance regulation, and work closely with the U.S. States, the National Association of Insurance Commissioners (NAIC), and the Board of Governors of the Federal Reserve System (Federal Reserve).

Before proceeding with comments regarding our engagement internationally, I would like to touch on efforts to promote transparency at the IAIS. As noted in our November 2018 joint report to this Committee, Treasury and the Federal Reserve support further increasing transparency and stakeholder input into IAIS decisionmaking.[1] We have advocated for this, and, consistent with this message, the IAIS noted in its 2020–2024 Strategic Plan that increasing transparency—particularly with respect to the decisionmaking process—continues to be a priority for the organization. The IAIS has committed to build on the direction set forth in its 2017 Stakeholder Engagement Plan to proactively and effectively engage with its broad range of stakeholders.[2] We will continue to engage in this area as the IAIS begins implementation of its new strategic plan.

Domestically, Treasury routinely hosts meetings with U.S. insurance industry stakeholders for open dialogue regarding policies being discussed at the IAIS. FIO also provides updates on its IAIS work at the open meetings of the Federal Advisory Committee on Insurance, which provides advice and recommendations to assist FIO in carrying out its statutory authority.

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[1] *See* Treasury and Federal Reserve, *Efforts to Increase Transparency at Meetings of the International Association of Insurance Supervisors* (November 2018), *https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2018_IAIS_Transparency_Report.pdf.*

[2] IAIS, *2020–2024 The IAIS Strategic Plan,* at 6, (June 2019), *https://www.iaisweb.org/page/about-the-iais/strategic-plan/file/82533/2020-2024-strategic-plan.*

Treasury will continue to provide formal and informal opportunities for U.S. stakeholders to engage with the U.S. members of the IAIS on issues arising before the IAIS.

With that background, I'll turn to a discussion of the IAIS, which is the international standard-setting body responsible for developing, and assisting in the implementation of, principles, standards, and other supporting material for supervision of the insurance sector.[3] The mission of the IAIS is to promote globally consistent insurance supervision in order to maintain safe insurance markets for the benefit of policyholders, and to contribute to global financial stability. IAIS members include insurance authorities from more than 200 jurisdictions.[4]

FIO has advocated for changes to the IAIS governance structure so that the United States can be more appropriately represented at the IAIS. As a result of recent governance changes, FIO now has a permanent seat on the IAIS Executive Committee, thereby providing all U.S. State and Federal representatives—which have come to be known collectively as "Team USA"—with a voice at the most senior levels of the IAIS. This change should help Team USA better advocate for supervisory standards that are in the best interests of the U.S. insurance market and its consumers.

Treasury is committed to continued engagement in the international standard-setting process. In international forums, the U.S. representatives advocate strongly and collectively for development of international standards that reflect the U.S. regulatory structure. As part of this advocacy, strong collaboration among members of Team USA is critical to ensuring that the United States conveys a coordinated view in international discussions.

Additionally, in 2009, the G–20 recognized the importance of international cooperation when it established the Financial Stability Board (FSB) to coordinate the work of the international standard-setting bodies and promote the implementation of effective regulatory, supervisory, and other financial sector policies. Treasury, the Federal Reserve, and the U.S. Securities and Exchange Commission are the U.S. members of the FSB. FIO coordinates with these members on insurance matters discussed at the FSB.

It is important to note that international standards are not, in and of themselves, binding in the United States—unless they are adopted as law through domestic processes at the State or Federal level. However, it is critical that the United States engage with our counterparts through such bodies. If standards developed in these forums are adopted by non-U.S. jurisdictions, they could have significant implications for U.S. insurers, and potentially for our domestic insurance regulatory regime. As noted by the Treasury Secretary in his May remarks at NAIC's International Forum, as U.S. insurers expand into foreign markets, they will have to navigate the supervisory regimes of other jurisdictions that may be influenced by international standards.[5]

Let me now turn to some of the ongoing work at the IAIS, and the related positions and activities of Treasury and FIO.

IAIS Initiatives

In accordance with the Economic Growth, Regulatory Relief, and Consumer Protection Act, Treasury and the Federal Reserve issued a joint report on September 6, 2019, on efforts with respect to global insurance regulatory or supervisory forums (Joint Report).[6] The Joint Report summarizes the work of FIO at international standard-setting bodies. I would like to highlight two important IAIS initiatives discussed in the Joint Report—the insurance capital standard (ICS) and the holistic framework.

a. Insurance Capital Standard

In July 2013, the FSB stated that the IAIS "will develop, and the FSB will review, a work plan to develop a comprehensive, group-wide supervisory and

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[3] *See* IAIS, *2017 IAIS Annual Report,* at 8 (2018), *https://www.iaisweb.org/page/about-the-iais/annual-report//file/77857/iais-ar-2017-digital-pdf-def-dp. See also* FIO, *Annual Report on the Insurance Industry,* at 36–37 (September 2018), *https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2018_FIO_Annual_Report.pdf.*

[4] IAIS, *2017 IAIS Annual Report,* at 8.

[5] Treasury, *Remarks by Treasury Secretary Steven T. Mnuchin at the National Association of Insurance Commissioners International Forum* (May 13, 2019), *https://home.treasury.gov/news/press-releases/sm688.*

[6] *See* Treasury and Federal Reserve, *Efforts of the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System with respect to Global Insurance Regulatory or Supervisory Forums in 2018* (September 2019), *https://www.federalreserve.gov/publications/files/Report-on-global-insurance-regulatory-or-supervisory-forums2019.pdf.*

regulatory framework for Internationally Active Insurance Groups (IAIGs), including a quantitative capital standard."[7] The next year, the IAIS started to create a comprehensive, group-wide supervisory and regulatory framework for IAIGs, known as ComFrame. ComFrame consists of both qualitative and quantitative supervisory requirements tailored to the complexity and international scope of IAIGs. The ICS, which is now under development at the IAIS, is a quantitative component of ComFrame and aims to be a measurement of capital adequacy for IAIGs. The IAIS's ultimate goal for the ICS is a single ICS that includes a common methodology by which one ICS achieves comparable, or substantially the same, outcomes across jurisdictions.[8]

Since 2015, the IAIS has conducted annual field testing of volunteer insurers, including U.S. firms, to inform the development of the ICS. The IAIS is scheduled to adopt an updated—but not yet final—version of the ICS (referred to as Version 2.0) in November 2019. This will be followed by a 5-year monitoring period from 2020 through 2024. During this period, the IAIS intends for the ICS to be used for confidential reporting to group-wide supervisors and for discussion in supervisory colleges. The present intention of the IAIS is for the ICS to be implemented after the monitoring period as a group-wide prescribed capital requirement for IAIGs. The IAIS also aims to be in a position by the end of the monitoring period to assess whether an aggregation method for group capital, such as that being developed by the United States, provides comparable outcomes to the ICS and can be considered an outcome-equivalent approach for implementation of the ICS.[9]

Treasury appreciates—and has contributed to—the work of the IAIS on the ICS effort and continues to support its overall objective of working to create a common language for supervisory discussion of group solvency.[10] However, as the Treasury Secretary outlined in his remarks at the NAIC's International Forum, we have concerns about certain aspects of ICS development and are working with our Team USA colleagues in pursuing constructive ways forward to potentially address those concerns within the IAIS.

- First, Treasury is working to improve the design of the ICS so that it more appropriately reflects the unique business model of insurers. In particular, one issue we have identified is 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. The ICS needs to appropriately consider long-term savings products that are critical to millions of Americans entering retirement.
- Second, Treasury believes it is important that the IAIS create a defined structure and process for further work and revisions on the ICS during the monitoring period from 2020 to 2024. The ICS adopted in November 2019 will most likely need further development and revision. Therefore, the IAIS needs to develop a process that ensures appropriate confidentiality for insurers during the 5-year monitoring period, while allowing the IAIS, its members, and other important stakeholders to continue evaluating, revising, and improving the ICS. Team USA must also remain actively engaged during this period and advocate for U.S. interests so that U.S. insurers remain competitive overseas and that international standards do not inappropriately affect U.S. insurance companies or the U.S. domestic insurance market.
- Third, it is important that the IAIS strengthen its efforts to develop a final ICS that is implementable in the United States. Treasury is focused on working with our Team USA members, 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" to the ICS. FIO will continue to advocate that the IAIS increase its focus on the important issues of comparability of outcomes, in order to enhance compatibility of the ICS with the United States' system of insurance regulation.
- Finally, getting the ICS right at the IAIS is more important than meeting any fixed schedule that mandates completion of the ICS at a specific point in time.

[7] FSB, Global systemically important insurers (G–SIIs) and the policy measures that will apply to them, at 2 (July 18, 2013), *https://www.fsb.org/wp-content/uploads/r_130718.pdf?page_moved=1.*

[8] IAIS, *Risk-Based Global Insurance Capital Standard Version 2.0: Public Consultation Document* (July 31, 2018), *https://www.iaisweb.org/page/supervisory-material/insurance-capital-standard/file/76133/ics-version-20-public-consultation-document* (*ICS Version 2.0 Consultation*).

[9] IAIS, *Implementation of ICS Version 2.0* (November 2, 2017), *https://www.iaisweb.org/file/69796/implementation-of-ics-version-20.*

[10] IAIS, *Risk-based Global Insurance Capital Standard Version 2.0.*

b. Holistic Framework

Another important international standard-setting initiative is the IAIS's proposed framework for assessing and mitigating systemic risk in the insurance sector (also known as the activities-based approach, or ABA). In 2017, the IAIS began work on the ABA, and in November 2017, the FSB noted that, once developed, such an approach may have significant implications not only for the assessment of systemic risk, but also for the identification of global systemically important insurers (G–SIIs) and G–SII policy measures.

In November 2018, the IAIS published a consultation document on a proposed framework for the assessment and mitigation of systemic risk in the insurance sector (the Holistic Framework).[11] In the consultation document, the IAIS stressed the need for additional work on potential liquidity risk. The IAIS also indicated that the potential implementation of the Holistic Framework should remove the need for an annual identification of G–SIIs by the FSB. The FSB has stated that it will review the need to either discontinue or re-establish an annual identification of G–SIIs by the FSB in consultation with the IAIS and national authorities in November 2022.

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 IAIS's efforts to develop improved standards for liquidity management and planning. As far as next steps, the IAIS is expected to adopt the Holistic Framework in 2019, for implementation by IAIS members in 2020.

Thank you again for the opportunity to testify today, and I look forward to your questions.

PREPARED STATEMENT OF THOMAS SULLIVAN

SUPERINTENDENT, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SEPTEMBER 12, 2019

Chairman Crapo, Ranking Member Brown, and Members of the Committee, thank you for your time and for your invitation to testify today on the Federal Reserve's efforts with respect to global insurance regulatory and supervisory forums.

The Board of Governors of the Federal Reserve System (Board) engages on global insurance regulatory and supervisory issues chiefly through its participation in the International Association of Insurance Supervisors (IAIS) alongside the U.S. Treasury's Federal Insurance Office, State insurance regulators, and the National Association of Insurance Commissioners (NAIC). The U.S. members of the IAIS are informally known as "Team USA." The mission of the IAIS is to promote effective supervision of internationally active insurance companies. It is important to note that none of the standards set by the IAIS have binding effect on the United States. We believe that it is in our national interest to engage in the international insurance standards-development process so that it produces standards that protect the U.S. market and U.S. consumers when foreign insurers operate here and are appropriate for U.S. companies operating abroad.

The Federal Reserve's participation at the IAIS is consistent with our responsibilities under law.[1] The Federal Reserve regulates insurance holding companies that own a federally insured depository institution and any designated by the Financial Stability Oversight Council (FSOC). The insurance thrift-holding companies supervised by the Federal Reserve represent over 10 percent of U.S. insurance industry assets and span a wide range of sizes, structures, and business activities. The core focus in our supervision is ensuring the safety and soundness of the supervised insurance institutions and protecting their subsidiary depository institutions. We leverage the work of State insurance regulators where possible and continuously look for opportunities to coordinate with them.

Our collaboration with the State insurance regulators and other Team USA members is prominently visible in our advocacy at the IAIS. Collectively, Team USA brings the relevant technical expertise to the work of the IAIS to identify and to address a range of policy issues. We are committed to continuing to support approaches that are appropriate for U.S. companies operating internationally.

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[11] IAIS, *Holistic Framework for Systemic Risk in the Insurance Sector: Public Consultation Document* (November 14, 2018), *https://www.iaisweb.org/page/consultations/closed-consultations/2019/holistic-framework-for-systemic-risk-in-the-insurance-sector/file/77862/holistic-framework-for-systemic-risk-consultation-document.*

[1] *See* 12 U.S.C. section 1467a.

The Federal Reserve also participates in insurance policy work streams as a member of the Financial Stability Board (FSB), which is responsible for monitoring and assessing vulnerabilities affecting the global financial system and recommending actions to address them. As part of this role, the FSB provides an appropriate framework for the work of the IAIS, but the responsibility for setting detailed international standards for insurance regulations rests with the IAIS.

In my testimony today, I would like to highlight and elaborate upon a few items discussed in the submitted report *Efforts of the U.S. Department of the Treasury and the Board of Governors of the Federal Reserve System with respect to Global Insurance Regulatory or Supervisory Forums in 2018.* First, I will comment on the efforts of the IAIS to develop an Insurance Capital Standard (ICS), arguably its most significant current project. Along with that, I will discuss the Federal Reserve's recent proposal of a capital rule that would apply to depository institution holding companies significantly engaged in insurance. The efficacy of this domestic approach should be useful to us during upcoming IAIS deliberations. After this, I will provide an update on the Federal Reserve's efforts to increase transparency at the IAIS and FSB.

Insurance Capital Standard

In 2013, the IAIS announced its plans to develop an ICS. The IAIS intends for the ICS to be a global, risk-based capital standard that is fit for application to all large internationally active insurance groups. To that end, the IAIS has engaged in two public consultations and four field tests, which assessed the impact of the ICS using data from large insurance companies that was provided on a voluntary basis. The IAIS plans to approve the ICS for confidential use during a 5-year monitoring period. The IAIS intends for the structure of the ICS to remain relatively stable during the monitoring period so that the current design and calibration of the ICS can be evaluated. To aid in the evaluation, large internationally active insurance groups will be able to report confidentially on the ICS to their home country supervisors.

An international standard, such as the ICS, could limit regulatory arbitrage and help provide a level playing field for internationally active insurance groups. An international standard could also help to ensure that internationally active U.S. companies are not held to bespoke and onerous standards when they operate in foreign countries. Additionally, it could reduce risk to U.S. consumers by ensuring that foreign insurers operating within the United States are held to appropriate capital regulation by their foreign groupwide supervisor.

There are concerns that the ICS currently includes a valuation method and other requirements that may not be optimal for the U.S. insurance market. Insurers generally operate with a buy-and-hold, long-term approach to investing, yet the ICS, as proposed, uses a market-based valuation method, whose volatility could ultimately reduce the availability of insurance products with long-term guarantees.

Because of these concerns, the Board has proposed applying a building block approach (BBA) to the insurers we supervise rather than the ICS in its current formulation. The BBA builds on existing State-based insurance standards, while also establishing minimum capital requirements that are specific to the business of insurance. The Board specifically sought to leverage the well-known insurance capital standards from State regulators to establish minimum requirements.

I support the NAIC's efforts to move forward with developing a Group Capital Calculation (GCC), which they successfully have moved into field testing.[2] We will continue to work with the NAIC to align these approaches to the greatest extent possible.

The Federal Reserve intends to continue to advocate for the recognition of the building block approach internationally. Through Team USA's efforts, we believe space has been created in the international dialogue for the BBA and GCC to be evaluated and recognized as an outcome-equivalent approach for the ICS. The BBA can assist in our collective advocacy by demonstrating how an approach that leverages existing capital requirements can work. Because of the concerns regarding the current design of the ICS, U.S. members support continued development of the ICS during the monitoring period. Furthermore, substantive changes to the ICS may emerge during the monitoring period given that elements of the developing standard have not been thoroughly tested and key areas remain unresolved.

Transparency

Team USA has continued to advocate for increased transparency at the IAIS. For example and most importantly, all significant policy proposals are subject to public

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[2] *See* NAIC, "Group Capital Calculation (E) Working Group," *https://naic-cms.org/cmte_e_grp_capital_wg.htm.*

consultation periods. Recently, the IAIS has established a norm that these periods will be for at least 60 days, allowing adequate time for the public to comment.

We also have advocated for obtaining stakeholder feedback earlier in the IAIS process. The development by IAIS of a Holistic Framework to mitigate systemic risk from the insurance industry is a good example of this. At the start of the IAIS's review of its macroprudential approach, key stakeholders were invited to present recommended changes. Several stakeholders suggested replacing the entities-based approach, which involved designating certain insurers as systemically risky, with an activities-based approach. The IAIS then worked to develop stakeholder ideas into a conceptual public consultation document, which was released in late 2017. Following this conceptual consultation, the IAIS released a more detailed consultation on its Holistic Framework in November 2018. Finally, earlier this year, the IAIS solicited input on the most granular details of the framework and plans to issue a final Holistic Framework this November. While this extensive engagement process required time, the IAIS has benefited from the engagement, and stakeholder reaction has generally been very supportive in this area.

The Federal Reserve has also worked to increase transparency at the FSB through its leadership role. Since December 2, 2018, Federal Reserve Vice Chair for Supervision, Randal K. Quarles has served as FSB chair. He has made increasing FSB transparency and stakeholder engagement a key part the group's agenda. Earlier this year, for the first time in the FSB's history, the FSB publicly disseminated its comprehensive work program. Vice Chair Quarles and the FSB continue to look for ways to further increase stakeholder engagement. The FSB is currently conducting a study of its regional consultative groups, which will improve the efficacy of outreach and feedback mechanisms. The FSB has also increased its direct engagement with insurers, including on the ICS. Recently, the FSB and IAIS held a joint stakeholder engagement event with representatives of the large internationally active insurance groups.

Thank you. I look forward to answering your questions.

PREPARED STATEMENT OF ERIC A. CIOPPA

SUPERINTENDENT, MAINE BUREAU OF INSURANCE,

ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

SEPTEMBER 12, 2019

Chairman Crapo, Ranking Member Brown, and Members of the Committee. My name is Eric Cioppa and I am the Superintendent for the Maine Bureau of Insurance and the President of the National Association of Insurance Commissioners (NAIC).[1] I am also the State insurance regulator representative to the Financial Stability Oversight Council (FSOC) and a member of the IAIS's Policy Development Committee. I am pleased to be here testifying alongside my Team USA colleagues.

The U.S. insurance market is the single largest and most competitive in the world, with State insurance regulators supervising more than one-third of global premium, and taken individually, U.S. States make up more than half of the 50 largest insurance markets. Given the size, breadth, and diversity of the U.S. insurance market, it is critical that the United States remain engaged in global regulatory standard-setting. In this regard, the NAIC is committed to continuing to provide leadership on such issues with a focus on ensuring policyholder protection and maintaining stable and competitive insurance markets. Our system, which helped our sector largely weather the most significant financial crisis since the Great Depression, has been continually improved since then and our efforts over the last decade domestically inform our work internationally.

As we work with our international counterparts and our Team USA colleagues, our primary objective is to develop the elements of an effective international insurance regulatory framework that are adaptable to the U.S. insurance market. While there are a variety of standard-setting workstreams at the International Association of Insurance Supervisors (IAIS), I would like to focus my testimony on two areas that have received the most attention here and abroad: 1) the development of the

[1] As part of our State-based system of insurance regulation in the United States, the National Association of Insurance Commissioners (NAIC) provides expertise, data, and analysis for insurance commissioners to effectively regulate the industry and protect consumers. The U.S. standard-setting organization is governed by the chief insurance regulators from the 50 States, the District of Columbia and five U.S. territories. Through the NAIC, State insurance regulators establish standards and best practices, conduct peer reviews, and coordinate regulatory oversight. NAIC staff supports these efforts and represents the collective views of State regulators domestically and internationally. For more information, visit *www.naic.org*.

IAIS's Insurance Capital Standard (ICS) and 2) the development of the holistic framework for systemic risk in the insurance sector. I will also touch on the IAIS's strategic plan.

Insurance Capital Standard (ICS)

The IAIS is currently in the process of developing a global Insurance Capital Standard for Internationally Active Insurance Groups (IAIGs). The ICS is being developed as a component of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), which is part of the IAIS's response to the last financial crisis to improve coordination and communication among supervisors and make groupwide supervision of IAIGs more effective and efficient. The ICS is a key project for the IAIS and scheduled to reach another milestone in November as it is expected that the ICS will move into a 5-year monitoring period.[2] It is anticipated that final adoption of the ICS will take place at the conclusion of the monitoring period, and jurisdictions will then determine whether to implement it.

NAIC Concerns With the ICS

The NAIC has long expressed serious concerns with ICS's trajectory and construction, many of which are shared by our Team USA colleagues.[3] Chief among them is its reliance on a market-adjusted valuation approach, which could create variability in company balance sheets and pressure insurers to sell assets contrary to the underlying economics of the product offering. This in turn could undermine the ability of firms to fulfill policyholder obligations and potentially disrupt financial markets. It also assumes capital is fully fungible between entities, which could lead to underfunding of individual insurance entities and increase the risk that non-insurance operations could pose to policyholders.

The ICS requirements also result in the nonrecognition of certain financial instruments critical to financing U.S. insurance operations as qualifying capital, and, includes capital charges that do not reflect the inherent risks of certain products. This potentially jeopardizes the ability of insurers to offer retirement products such as life insurance and annuities and make long-term investments, for example in infrastructure, where the marketplace plays a critical role. Put simply, the ICS remains not only technically flawed but also contrary to key policy initiatives in the United States such as retirement security, long-term care, infrastructure investment, and disaster resiliency.

Further, rather than developing a standard that has an appropriate level of flexibility to recognize the realities of jurisdictional differences and to provide a basis for enhanced supervisory cooperation and coordination, the ICS work to date largely reflects Europe's approach to regulation. Favoring specific supervisory approaches over others has not been helpful to the process of developing what was intended to be a *global* standard. A regulatory standard that cannot be adopted by the world's largest jurisdictions, and, therefore, does not create safer insurance markets globally, is not an international standard regardless of the label applied to it. Europe has been very transparent about its objective of ensuring that the ICS "remains in line with Solvency II principles."[4] Europe's efforts to protect and export Solvency II

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[2] The purpose of this 5-year monitoring period is to evaluate the performance of the current ICS over a period of time. During the monitoring period, the ICS will be used for confidential reporting to group-wide supervisors and discussion in supervisory colleges as well as to receive feedback from IAIGs. However, it will not be used to measure the capital adequacy of IAIGs nor as a basis to trigger supervisory action. Rather, the input received during the monitoring period will be used to further improve the ICS.

[3] *See, e.g.,* Remarks by Treasury Secretary Steven T. Mnuchin at the *National Association of Insurance Commissioners' International Forum,* Washington, DC, at *https://home.treasury.gov/news/press-releases/statements-remarks* (May 13, 2019); and Remarks by Federal Reserve Vice Chairman for Supervision Randal K. Quarles re: *Insurance Supervision and International Engagement* at the American Council of Life Insurers Executive Roundtable, Naples, Florida at *https://www.federalreserve.gov/newsevents/speeches.htm* (January 9, 2019). *See also,* Remarks by Daniel K. Tarullo re: *Insurance Companies and the Role of the Federal Reserve* at the National Association of Insurance Commissioners' International Forum, Washington, DC, at *https://www.federalreserve.gov/newsevents/speech/files/tarullo20160520a.pdf* (May 20, 2016).

[4] *See Annual Report of the European Insurance and Occupational Pensions Authority, https://eiopa.europa.eu/Publications/Reports/EIOPA_2018%20Annual%20Report.pdf,* at 51 (2018) ("With the aim of pursuit of Solvency II as the practical implementation of the International Association of Insurance Supervisors' (IAIS) International Capital Standard (ICS), EIOPA's target was for the ongoing development of the ICS remains in line with Solvency II principles: market consistency and risk-based. The ICS Field Testing was launched by the IAIS in May. Due to its stability and comparability, it contained, for the reference ICS, a market-adjusted

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by reflecting it in the ICS has been to the detriment of meeting the IAIS's stated mission to " . . . develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability."[5] Rather than working to develop a global capital standard that is broadly implementable and useful for a variety of jurisdictions, we are being confronted with an ICS that is simply the most "convenient" standard for Europe.

Given our concerns, we have determined that the ICS as currently constructed would not be adaptable to the U.S. insurance market and would not be a useful tool for our supervisory framework—indeed, it could cause undue harm. Instead, together with our Team USA colleagues, we are developing an Aggregation Method which is different than the ICS, but an approach we feel will provide comparable outcomes for the group-wide supervision of IAIGs as the ICS. The IAIS has agreed to assess the Aggregation Method during the upcoming monitoring period.

The Aggregation Method will be informed by our Group Capital Calculation (GCC) and by the proposed Building Block Approach recently released by the Federal Reserve for Savings and Loan Holding Companies predominantly engaged in insurance operations. These approaches build off our U.S. legal entity Risk Based Capital (RBC), which has been tested over time, and thus we are confident that the resulting group capital methodology will be a more meaningful and valuable tool for U.S. insurance regulators. It is to the collective credit of Team USA that in just 2 years we've gone from a theoretical approach for group capital to a working model demonstrating our commitment to a truly workable approach for our market.

Unlike the ICS, which is a top-down capital standard, an Aggregation Method would rely on a bottom-up approach to capital, aggregating legal entity regulatory capital requirements and making scalar adjustments based on jurisdictional differences as well as risks that are otherwise not captured in the aggregation. It is our view that an aggregation method is not only comparable, but superior to the current ICS as it provides more transparency into the capital structure and local risks within a group and uses less volatile accounting methods. We recognize the importance of being able to assess group capital and discuss related issues with our foreign counterparts. The Aggregation Method will allow those assessments and discussions to occur, but in a manner that will work with the U.S. insurance regulatory framework and avoid some of the troubling aspects of the ICS.

Next Steps

Importantly, the advancement of the ICS to the monitoring period is the next step in the process, but not the final one. In coordination with our Team USA colleagues, we will continue to move forward on a parallel track to address our concerns. First, we recognize that some large U.S. insurers who do business in other jurisdictions may have to comply with ICS or ICS-like standards as implemented in those markets in the future. Consequently, we are working with our IAIS colleagues to address the deficiencies of the current ICS and seek design changes that would take better account of how U.S. insurers operate. Second, we are working to develop and promote an approach to assessing the Aggregation Method, or any other alternatives to the ICS, such that by the conclusion of the ICS monitoring period it should be deemed an appropriate jurisdictional alternative that provides comparable outcomes.

In the short term, between now and November, there are several IAIS meetings that will give Team USA the opportunity to further shape the discussions going forward. In these coming meetings, it will be critical that Team USA continues to translate their strong public statements on the ICS into an equally committed strategy heading into these next critical meetings. From our perspective, the IAIS should establish a definition of comparability that provides a viable path forward for the aggregation method to be recognized as providing comparable outcomes to the ICS, in spite of any structural differences that may exist. The focus of comparability should be on whether regulators are empowered to take action on a group capital basis, and not a granular compliance exercise to an ICS standard with inherent flaws.

We are also working bilaterally with individual IAIS members to share with them our perspectives, hear their views with regards to the ICS and seek opportunities to build bridges and mutual respect between our respective jurisdictions. Furthermore, we hope the information collected from IAIGs and input from the relevant group-wide supervisors during the monitoring period will illustrate our concerns

valuation (MAV) approach with a single discounting curve. All elements for a practical implementation of Solvency II are contained and the target was therefore judged to be met").

[5] See *https://www.iaisweb.org/home.*

with the ICS's construction and demonstrate to our foreign counterparts the merits of the Aggregation Method.

While we remain committed to the ultimate objective of an ICS and contributing to its development, it is premature if not irresponsible to make more definitive commitments to a standard that presently all members of Team USA view as inherently flawed. Such commitment would undermine the very point of a monitoring period, which should not be the conclusion of the ICS's development, but another opportunity to test it along with the Aggregation Method. But let me also be clear, we will not be implementing the current ICS in the U.S. States are moving forward with a Group Capital Calculation and the Fed is moving forward with a Building Block Approach, both of which are compatible with the Aggregation Method. We believe this is the best path forward for U.S. policyholders and market participants, while remaining consistent with the underlying purpose of the ICS.

Holistic Framework for Systemic Risk

Concurrently with its work on the ICS, the IAIS is also in the process of developing a Holistic Framework for Systemic Risk in the Insurance Sector. The 2008 global financial crisis underscored the interconnected nature of financial institutions, as well as the risks they pose to the financial system when in distress. While the insurance industry is generally a stabilizing force by providing consumers products that protect them against the risk of loss, there was recognition that certain activities and interconnectedness could pose risks to the broader financial system. As a result, the IAIS and the Financial Stability Board worked to develop a process to assess insurers' systemic risk and policy measures designed to prevent catastrophic failure in the insurance sector. In this regard, work began on an entity-based approach that sought to identify Global Systemically Important Insurers, or G–SIIs. However, it soon became apparent that an entities-based approach was not a good fit for the sector because it was too narrow in its focus. In late 2018, the IAIS released a proposed Holistic Framework for Systemic Risk that prioritized taking more of an activities-based approach.

The proposed Holistic Framework intends to serve as the basis for identifying and addressing any risks in the insurance sector that could emanate from distress of individual insurers or, alternatively, from the activities of solvent insurers through their collective exposures or responses to shocks to the financial system. This approach considers the cross-sectoral aspects of systemic risks by incorporating comparisons of risks among insurers and financial sector actors such as banks. The proposed framework involves the following key elements:

1) a set of preemptive supervisory tools designed to help prevent insurance sector vulnerabilities and exposures from developing into systemic risks;
2) ongoing monitoring by the IAIS designed to detect potential systemic risks in the insurance sector;
3) supervisory authorities designed to respond to any identified potential systemic risks;
4) mechanisms to help ensure consistent application of the of framework; and
5) an assessment of the IAIS of the consistent implementation of preemptive supervisory tools and intervention authorities.

The NAIC welcomed this shift in thinking as the activities-based approach is targeted at the risks of concern rather than at a subset of companies that may not fully capture the full extent of the risk to the system or sector. Such an approach is more aligned with our domestic direction, particularly with respect to the NAIC's Macroprudential Initiative, which is focused on risks within the insurance sector that could have broader impacts on the financial system and vice-versa, as well as the FSOC's proposed prioritization of an activities-based approach.

The development of the Holistic Framework is ongoing, and we continue to carefully monitor how the proposals will move from concept to reality to ensure they do not go beyond the intended scope of insurers that are engaged in potentially systemically risky activities. The IAIS has been refining the framework this year based on input from members and stakeholders, and new policy measures will be up for adoption at the IAIS Annual General Meeting in November.

IAIS Strategic Plan and Transparency

Turning to IAIS more broadly, in June, the IAIS approved its 2020–2024 Strategic Plan that lays out a new strategic direction that we generally support. While the post-crisis policy work on systemic risk and group capital which has been the focus of the current plan is important, it has also taken up a large amount of IAIS time, resources and attention. In the meantime, new issues and risks have and will continue to emerge. This new strategic plan better balances the work of the IAIS, makes it more forward-looking and puts more emphasis on supporting its membership of insurance supervisors around the globe. Many of the priorities the IAIS has identified are issues that the NAIC is actively engaged and making progress on as well: expanding our macroprudential surveillance toolkit; examining and addressing the impact of innovation and technology on the consumers, industry, and regulators; cybersecurity; data privacy; and climate risk and resilience. We look forward to contributing our knowledge, expertise and leadership on these important issues.

Additionally, we continue to believe that critical to the credibility of the standard-setting activities at the IAIS is an inclusive and transparent decisionmaking process. We are pleased to see that the IAIS's strategic plan includes the enhancement of stakeholder communication as one of its goals and look forward to working with our IAIS colleagues to further enhance the transparency of IAIS discussions. For our part, the NAIC has long-standing procedures and ongoing responsibilities to seek input from policyholders and other interested parties, and we will continue to work on these issues in a transparent manner through our NAIC process.

Conclusion

In conclusion, well-regulated markets, both here and abroad, make for well-protected policyholders. Given the important role the insurance sector plays in providing protection and retirement security to U.S. consumers, it is critically important that any international regulatory standards be developed in a manner that are adaptable to our markets and do not threaten their stability. To that end, the NAIC remains committed to continued engagement in international insurance standard-setting discussions alongside our Team USA colleagues to ensure this result.

Thank you for the opportunity to testify today and I would be pleased to take your questions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM STEVEN E. SEITZ

Q.1. Should the IAIS adjust its International Capital Standards (ICS) to comport with the structure of the U.S. insurance market prior to adoption for monitoring?

A.1. The Federal Insurance Office (FIO) believes that it is important that the International Association of Insurance Supervisors (IAIS) strengthen its efforts to develop a final ICS that is compatible with the U.S. regulatory structure. FIO will continue to advocate that the IAIS increase its focus on the important issues regarding comparability of outcomes, in order to enhance comparability of the ICS with the U.S. system of insurance regulation.

Q.2. How can the operational effectiveness of ICS be properly examined if it has identified flaws from the outset?

A.2. FIO believes that it is important that the IAIS create and maintain a defined structure and process for further work and revisions on the ICS during the monitoring period from 2020 to 2024. This process should ensure appropriate confidentiality for insurers during the monitoring period, while allowing the IAIS, its members, and other stakeholders to continue evaluating, revising, and improving the ICS. FIO will remain actively engaged during this period and advocate for U.S. interests so that U.S. insurers remain competitive overseas and so that international standards do not inappropriately harm U.S. insurance companies or the U.S. domestic insurance market.

Q.3. Specifically, what adjustments to ICS would you like to see prior to its adoption?

A.3. At the IAIS meetings in Abu Dhabi, FIO registered its official objection to the IAIS's advancement of version 2.0 of the ICS into a 5-year monitoring period. Among other things, the current form of the ICS could risk limiting U.S. consumers' access to important long-term savings products. The IAIS needs to continue improving and revising the design of the ICS so that it more appropriately reflects the business model of insurers. Additionally, the IAIS should consider the increased use of jurisdictional flexibility in the design of the ICS so that the ICS could better meet the differing market needs across various jurisdictions. During the 5-year monitoring period, FIO will continue to advocate strongly for further improvements to the ICS in these and other areas.

RESPONSE TO WRITTEN QUESTION OF SENATOR MENENDEZ FROM STEVEN E. SEITZ

Q.1. Before the International Association of Insurance Supervisors (IAIS) votes on adoption of the new international capital standards, there will be two meetings this month and next to lay the groundwork for the annual General Meeting in November.

How will each of you approach these meetings and what outcomes do you hope to achieve?

A.1. Before and during these meetings of the IAIS, the FIO worked closely with the other U.S. members of the IAIS—the U.S. States, the National Association of Insurance Commissioners (NAIC), and the Board of Governors of the Federal Reserve (collectively known as Team USA).

FIO will continue to work collaboratively as part of Team USA in our engagement with the IAIS to advance U.S. interests. As outlined in my written testimony, FIO will work together with Team USA and other stakeholders to address its concerns with the current development of the ICS.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM STEVEN E. SEITZ

Q.1. In your view, does the capital framework that exists as part of the U.S. State-based insurance regulatory regime provide similar protections as the proposed ICS Version 2.0 standard?

A.1. There are important differences between the capital framework that currently exists in the U.S. State-based insurance system and the proposed ICS Version 2.0 standard. The ICS seeks to establish a group-wide capital standard that aims to be a measure of capital adequacy for internationally active insurance groups. Under the U.S. State-based insurance regime, the current U.S. risk-based capital standard is applied at the insurance legal entity level. The U.S. States, through the National Association of Insurance Commissioners (NAIC), are in the process of developing a group capital calculation (GCC), which will serve as an analytical tool to provide a baseline quantitative measure for group risks. Additionally, the ICS is intended to serve as a prescribed capital requirement, whereas the NAIC intends for the GCC to assist regulators with taking informed and appropriate action in response to potential risks arising from other parts of the holding-company system.

Q.2. In your written testimony, you referenced a 5-year monitoring period following the adoption of ICS Version 2.0 in November 2019. During the period, IAIS intends to use the ICS for confidential reporting to group-wide supervisors. In your view, is that additional data necessary?

A.2. It is important that the IAIS create and maintain a process during the monitoring period for the ICS that ensures appropriate confidentiality for insurers. The monitoring period is designed to provide feedback on the effectiveness of ICS Version 2.0, and should be an iterative process for the IAIS and its members to continue revising and improving the ICS.

Q.3. In March 2018, IAIS, in conjunction with the Sustainable Insurance Forum (SIF), released an issue paper that detailed the climate risk to the insurance sector.[1]

Do you agree with the report's statement that the "potential for physical and transition risks to pose risks for [the] solvency of individual firms, stemming from underwriting and investment activities"?

A.3. U.S. State regulators are continually monitoring solvency risks. For example, the NAIC revised its Financial Condition Examiners Handbook to provide guidance for examiners on what questions to ask insurers regarding any potential impact of climate change on solvency.

In addition, insurers do not appear to have material exposure to carbon-related investments. In the current Financial Sector Assessment Program being conducted by the IMF in the United States, the IMF surveyed 22 life insurers, 21 P&C insurers, and 7 health insurers for carbon-related exposures in their investment portfolios. The IMF found that less than 1 percent of both their equity investments and bond investments were carbon-related.

Q.4. If not, why not?

A.4. See response above.

Q.5. Do you believe that further efforts are necessary to quantify the potential risks associated with climate change?

A.5. As part of its statutory mandate, FIO continuously monitors the status of the insurance industry. Insurers do not appear to have material exposure to carbon-related investments, as noted above. More generally, FIO is working with FEMA and the Mitigation Framework Leadership Group (MitFLG, a national structure to coordinate mitigation efforts across the Federal Government and with State, local, tribal, and territorial representatives) to improve national resilience through the development of the National Mitigation Investment Strategy. As noted in its 2019 Annual Report, FIO continues to support efforts to improve the availability of insurance and take-up of insurance. FIO is also engaging with its Federal Advisory Committee on Insurance, which is composed of a variety of stakeholders, including industry executives, consumer representatives, State regulators and legislators, and academics.

Q.6. Would requiring companies to disclose their exposure to greenhouse gas emissions and their fossil-fuel related assets help mitigate the risk some of these insurers face in their investment activities?

A.6. The U.S. States are the primary regulators of insurance in the United States, and they are best positioned to assess what disclosures are necessary for the insurance companies doing business in their States. For example, the California Department of Insurance has previously required all insurers doing business in that State to publicly disclose all of the carbon-related investments in their portfolios.

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[1] International Association of Insurance Supervisors, "Issues Paper on Climate Change Risks to the Insurance Sector," 2018, *https://www.iaisweb.org/file/73565/sif-iais-issues-paper-on-climate-risk-to-the-insurance-sector-clean.*

Q.7. In your written testimony, you stated, "Treasury supports shifting the focus of systemic risk analysis away from individual insurance entities and toward the activities of insurers and other market participants." You also expressed support for removing the FSB annual identification of G–SIIs in the implementation of the holistic framework.

Do you believe that American International Group, Inc., Prudential Financial, Inc., and MetLife, Inc., have reduced their risk profiles sufficiently since the financial crisis?

A.7. FSOC has the authority to require that a U.S. nonbank financial company, including an insurance company, be supervised by the Board of Governors of the Federal Reserve and subject to prudential standards if FSOC determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States. No U.S. nonbank financial company is currently subject to such a designation by FSOC. FSOC voted to rescind the designations of AIG and Prudential, while MetLife successfully contested its designation in Federal court. FSOC's analyses in connection with its rescission of the designations of AIG and Prudential are available on FSOC's website.[2]

Q.8. Do you believe that an insurance company's overall risk profile, including its interconnectedness to other institutions and overall leverage exposure, should not be considered when determining the appropriate regulatory framework for that company?

A.8. An insurance company's overall risk profile should be considered when determining the appropriate regulatory framework for the company.

Q.9. Describe the tools that regulators would have under an activities-based approach to proactively identify activities that insurance companies engage in that are risky and prevent firms from restructuring or renaming those activities?

A.9. FSOC's December 2019 final interpretive guidance on nonbank financial company determinations sets forth an activities-based approach for identifying and addressing potential risks to financial stability. The activities-based approach consists of two steps: (i) identifying and evaluating potential risks to financial stability from products, activities, or practices; and (ii) working with regulators to address any identified risks to financial stability. In the first step of the activities-based approach, FSOC's work may include efforts such as sharing data, research, and analysis among FSOC members and member agencies and their staffs; consulting with regulators and other experts regarding the scope of potential risks and factors that may mitigate those risks; and collaboratively developing analyses for consideration by FSOC. If, after engaging with relevant financial regulatory agencies, FSOC believes those regulators' actions are inadequate to address an identified potential risk to U.S. financial stability, FSOC has authority to make formal,

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[2] See *https://home.treasury.gov/system/files/261/Prudential-Financial-Inc-Rescission.pdf, https://www.treasury.gov/initiatives/fsoc/designations/Documents/American__International__Group,__Inc.__(Rescission).pdf.*

nonbinding recommendations to primary financial regulatory agencies under section 120 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SASSE FROM STEVEN E. SEITZ

Q.1. I understand that the International Capital Standard (ICS) produced by the International Association of Insurance Supervisors (IAIS) is nonbinding to U.S. insurers until it is either adopted by regulators or enacted into law by Congress.

Could you discuss the potential ramifications on U.S. insurers operating in markets abroad even if the standards produced through IAIS are nonbinding on U.S. insurers?

A.1. International standards like the ICS are not binding in the United States, unless they are adopted as law through domestic processes at the State or Federal level. However, if standards developed in forums such as the IAIS are adopted by non-U.S. jurisdictions, even if they are not adopted in the United States, they could have significant ramifications for U.S. insurers and potentially for our domestic insurance regulatory regime. As U.S. insurers expand into foreign markets, they will have to navigate the supervisory regimes of other jurisdictions that may be influenced by international standards. For example, if adopted in other jurisdictions, the ICS could have negative effects on the ability of U.S. insurers to provide long-term savings products in those jurisdictions.

Q.2. What disadvantages or repercussions could our insurers at home in the United States face?

A.2. The Federal Insurance Office (FIO) registered its official objection to the IAIS's advancement of version 2.0 of the ICS into a 5-year monitoring period. The current form of the ICS could risk limiting U.S. consumers' access to important long-term savings products and potentially increase costs for U.S. insurers and U.S. consumers. Considering the importance of these issues to the U.S. insurance market, FIO is committed to strong and continued engagement at the IAIS during the ICS monitoring period and in other important IAIS work streams. FIO will continue to advocate for U.S. interests at the IAIS, and push for international standards that reflect the U.S. insurance regulatory system.

Q.3. The United States represents over 40 percent of the world's insurance market and has one of the most robust, well-developed insurance regulatory systems in the world. One that both protects consumers, but also encourages competition and innovation. With this in mind, the Federal Reserve in January of this year at a roundtable stated that it would "continue to advocate for international insurance standards that promote a global level playing field and work well for the U.S. insurance market."

Is the U.S. insurance industry well-regulated and protecting consumers today?

A.3. The U.S. insurance sector, which is primarily regulated by the U.S. States, plays a critical role in the U.S. economy and ensuring the stability of the U.S. financial system. The American people count on the insurance industry to help them in times of need. The

United States has the largest and most diverse insurance market in the world. U.S. insurance premiums were over $2 trillion in 2018, an amount that exceeds 10 percent of the U.S. gross domestic product.

Q.4. If yes, what is ICS solving for since the ICS as proposed would disadvantage U.S. insurers?

A.4. FIO appreciates—and has contributed to—the work of the IAIS on the ICS effort and continues to support its overall objective of working to create a common language for supervisory discussion of group solvency. However, at the IAIS meetings in Abu Dhabi, FIO registered its official objection to the IAIS's advancement of version 2.0 of the ICS into a 5-year monitoring period. The current form of the ICS could risk limiting U.S. consumers' access to important long-term savings products and potentially increase costs for U.S. insurers and U.S. consumers. Considering the importance of these issues to the U.S. insurance market, FIO is committed to strong and continued engagement at the IAIS during the ICS monitoring period and in other important IAIS work streams. FIO will continue to work collaboratively as part of Team USA in our engagement with the IAIS.

Q.5. Insurance companies in the United States have been regulated for over 150 years. We have a marketplace that services consumers well and is solvent. Why are we taking direction from Europe on how to best regulate our insurance industry?

A.5. Throughout its engagement at the IAIS and in other international forums, FIO will continue to strongly advocate for U.S. interests and the U.S. State-based system of insurance regulation. It is important for FIO to advocate on these issues because if standards developed in forums such as the IAIS are adopted by non-U.S. jurisdictions, even if they are not adopted in the United States, they could have significant ramifications for U.S. insurers, and potentially for our domestic insurance regulatory regime.

Q.6. Europe has a government-supported retirement system, unlike the United States where most retirement is managed in the private sector, how could these different systems impact the way capital is calculated?

A.6. The different retirement systems in Europe and the United States could affect how each jurisdiction calculates capital for insurance companies. For example, the market valuation approach used by Europe under Solvency II (and similarly used in the ICS) could have negative effects on the ability of insurance companies to provide long-term savings products, which are particularly important to insurers and policyholders in the United States. Depending on the retirement system of a particular jurisdiction, these products may not play as important a role for consumers saving for retirement in that jurisdiction.

Q.7. What is the reason that the United States needs European insurance standards imposed on U.S. insurance companies?

A.7. The United States has the largest and most diverse insurance market in the world and does not need to import EU insurance standards into the United States. The U.S. States are the primary regulators of the business of insurance in the United States, and it is important that international standards are compatible with the U.S. insurance regulatory regime. During the recent IAIS meetings in Abu Dhabi, FIO objected to the advance of version 2.0 of the ICS into the monitoring period. During these negotiations, FIO took positions that were consistent with our objectives of ensuring that U.S. insurers remain competitive overseas and not allowing international standards to inappropriately harm U.S. insurance companies or the U.S. domestic insurance market.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM STEVEN E. SEITZ

Q.1. How could insurance companies pose a threat to U.S. financial stability?

A.1. As demonstrated during the 2008 financial crisis, an insurance company may pose a threat to U.S. financial stability due to the nature and extent of its activities (such as engaging in extensive capital market activities).

Q.2. How frequently in the past 15 years did property and casualty or life insurers become insolvent? How many of the claims to insolvent firms were not covered? How many of the claims to insolvent firms were covered by the Guarantee Associations?

A.2. Since 2005, there have been 22 life and health insurer receiverships and 98 property & casualty (P&C) company insolvencies.[1] While the size of the insurers involved in these insolvencies varied, most were relatively small insurers. Average recoveries on life insurance policies have generally exceeded 96 cents per dollar, and average recoveries on annuity claims have been 95 cents per dollar. While recovery rates from P&C insurer insolvencies have been lower, they are still substantial.

Q.3. Are there any insurance companies now—either from their nature, scope, size, scale, concentration, interconnectedness, or mix of activities—that could pose a threat to U.S. financial stability? If yes, what do you recommend we do about these potential threats?

A.3. The Financial Stability Oversight Council (FSOC) has the authority to require that a U.S. nonbank financial company, including an insurance company, be supervised by the Board of Governors of the Federal Reserve System (Federal Reserve) and subject to prudential standards if FSOC determines that material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States. No U.S. nonbank financial company is currently subject to such a designation by FSOC.

In December 2019, FSOC published final interpretive guidance on nonbank financial company determinations, which describes the

[1] Life and health insurer receivership data is from the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA), while the National Conference of Insurance & Guaranty Funds (NCIGF) provided data on P&C company insolvencies. NOLHGA receivership data includes only companies with operations in at least three States and where NOLHGA was involved. NCIGF data only includes insolvencies through the second quarter of 2018. By convention, companies are organized either as "life and health" (and may be authorized to write life, accident, and/or health insurance), "property and casualty," or "health" (when authorized to write only health insurance).

approach that FSOC intends to take in prioritizing its work to identify and address potential risks to U.S. financial stability using an activities-based approach. In order to fulfill its statutory duties, FSOC stated that it will monitor the financial services marketplace, including insurance, to identify potential threats to U.S. financial stability. Under the recently published guidance, FSOC enhanced the analytical rigor and transparency in the processes FSOC intends to follow if it were to consider making a determination to subject a nonbank financial company to supervision by the Federal Reserve.

Q.4. The International Association of Insurance Supervisors (IAIS) approved its 2020–2024 Strategic Plan this summer. It also included cyber resilience and climate risk. Can you tell me more about the goals the IAIS has to reduce risks related to cyber-attacks and climate change?

A.4. The IAIS Strategic Plan sets out the association's goals, including with respect to reducing cyber-attacks and climate change-related risks. Specifically, the Strategic Plan includes as Goal 2: "The IAIS sets and maintains globally recognized standards for insurance supervision that are effective and proportionate." The Strategic Plan further explains that, in connection with this goal, the IAIS will "incorporate a more strategic approach to emerging trends such as cyber, climate risk, insurtech, *etc.*" The Federal Insurance Office (FIO) will advance U.S. interests by working with the IAIS and its members.

Q.5. What investment strategies are insurance carriers taking in relation to climate risk versus what new policies options or restrictions are becoming prevalent to address climate change?

A.5. In the current Financial Sector Assessment Program being conducted by the International Monetary Fund (IMF) in the United States, the IMF surveyed 22 life insurers, 21 P&C insurers, and seven health insurers for carbon-related exposures in their investment portfolios. The IMF found that less than 1 percent of both their equity investments and bond investments were carbon-related. In addition, some large insurers have pledged to limit their insurance coverage for certain fossil fuel companies. More generally, FIO is working with Federal Emergency Management Agency and the Mitigation Framework Leadership Group (MitFLG, a national structure to coordinate mitigation efforts across the Federal Government and with State, local, tribal, and territorial representatives) to improve national resilience through the development and implementation of the National Mitigation Investment Strategy. FIO is also engaging with its Federal Advisory Committee on Insurance, which is composed of a variety of stakeholders, including industry executives, consumer representatives, State regulators and legislators, and academics.

Q.6. How are different nations requiring insurance firms to consider the impacts of climate change?

A.6. In 2018, the IAIS and the Sustainable Insurance Forum (SIF) issued a paper "Climate Change Risks to the Insurance Sector." This paper provides an overview of how climate risks are currently affecting and may in the future affect the insurance sector. The paper also reviews the relevant supervisory practices in different jurisdictions based on responses to a SIF survey. The paper outlines case studies highlighting the efforts and key findings in this area of nine different jurisdictions, including California and Washington. As the business of insurance in the United States is primarily regulated by the U.S. States, it is important that the Federal Government, including FIO, closely coordinate with the U.S. States on their respective efforts to require insurance firms to consider the impacts of climate change. The National Association of Insurance Commissioners (NAIC) also revised its Financial Condition Examiners Handbook to provide guidance for examiners on what questions to ask insurers regarding any potential impact of climate change on solvency.

Q.7. The International Association of Insurance Supervisors (IAIS) is working to evaluate the use of financial technology and insurance. Can you tell me more about issues related to artificial intelligence, the use of algorithms, and data privacy?

A.7. The IAIS is currently developing an issues paper on the use of big data analytics in insurance; a draft of the paper was published for public comment in September 2019. The draft paper identifies the following as "supervisory considerations:" the suitability, affordability, and availability of insurance coverage; governance and oversight of algorithms; third-party risk management; and issues regarding privacy, ownership, and sources of data.

FIO has also done extensive work examining insurtech issues over the last several years and most recently in its 2019 annual report, including issues related to AI, big data and the use of algorithms, and data privacy. The annual report details how the use of big data analytics (including the use of AI and algorithms) can present both opportunities and challenges for consumers and insurers, particularly with respect to rate model review. In particular, new technologies can change the relative market power of insurers and consumers, raise issues with respect to transparency, and create new supervisory challenges. FIO intends to continue its work with regard to insurtech and expects to continue writing about the topic and related issues such as the use of big data, data privacy, and others in future annual reports.

Q.8. How do you monitor the property and casualty insurance companies to ensure fintech and insurtech innovations do not lead to discrimination? How do you ensure compliance with the Fair Housing Act?

A.8. Among its duties, FIO monitors all aspects of the insurance industry, but its role is not to ensure compliance with the Fair Housing Act. Through FIO's research, analysis, and discussions with insurance stakeholders (including regulators, insurers, brokers, and consumer representatives), FIO monitors a wide range of insurance issues and reports on them through its various reporting requirements. FIO's 2019 annual report discusses insurtech issues as well as the Fair Housing Act's Disparate Impact Rule.

Q.9. The Nevada Insurance Commissioner told me that the Covered Agreement standards were developed using banking capital standards, rather than insurance capital standards. Can you explain the difference between the controls that banks have in place versus the controls that insurers have in place? I'm specifically interested in the use of the reinsurance tools that insurance carriers have available to them that banking systems do not.

A.9. The two covered agreements, the Bilateral Agreements between the United States and the European Union (EU) and the United States and the United Kingdom on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreements), were negotiated pursuant to the Federal Insurance Office Act of 2010 and provide meaningful benefits for the United States, its insurance industry, and their customers. The UK Covered Agreement was negotiated in anticipation of Brexit and has not yet entered into force. The Covered Agreements were not developed using banking capital standards. The Covered Agreements address three areas of prudential insurance supervision: group supervision; reinsurance, including reinsurance collateral; and exchange of information between supervisory authorities. Importantly, the agreements also protect consumers and affirm the U.S. system of insurance regulation, including the role of State insurance regulators as the primary supervisors of the business of insurance in the United States.

For example, under the U.S.–EU Covered Agreement, a U.S. insurer is able to operate in the European Union without subjecting its U.S. parent to potentially costly worldwide group capital requirements (and other group supervision requirements), which may otherwise have been applicable under Solvency II. Additionally, under the U.S.–EU Covered Agreement, U.S. reinsurers are not required to establish a local EU presence in order to assume business from EU ceding insurers.

Q.10. Do you think that the international insurance supervisors who focus on insurance capital standards are open to alter their oversight standards to be considered "substantially similar" to the U.S. standards?

A.10. FIO registered its official objection to the IAIS's advancement of version 2.0 of the insurance capital standard (ICS) into a 5-year monitoring period. FIO will continue to advocate that the IAIS increase its focus on the important issues of comparability of outcomes, in order to enhance comparability of the ICS with the U.S. system of insurance regulation. FIO will continue to work collaboratively as part of Team USA in our engagement with the IAIS during the ICS monitoring period. FIO, together with the other U.S. members of the IAIS—the U.S. States, the NAIC, and the Federal Reserve—are collectively known as Team USA.

Q.11. The European Union established Solvency II. Can you describe how the Minimum Capital Requirements work? What is considered? What happens when an insurance company falls below the Minimum Capital Requirements?

A.11. Solvency II introduces two tiered capital requirements—a solvency capital requirement and a minimum capital requirement (MCR). Solvency II includes a tiered ladder of supervisory intervention that becomes increasingly more severe as the capital of an insurance company approaches the MCR. The MCR represents the minimum level of capital that firms are required to maintain and the threshold below which a regulator would intervene. Regulators in the European Union have a variety of options to address breaches of the MCR (including the potential withdrawal of an insurer's authorization). The MCR is calculated as a factor-based linear formula that is targeted at an 85 percent confidence level.

Q.12. Solvency II has three pillars. Pillar 3 requires insurers file annual reports with their regulator and make them available to the public. Have you had any feedback from the public based on one of those reports?

A.12. While FIO routinely reviews these reports, it has not received any feedback from the public on these reports.

Q.13. If the United States did not agree to use the same Solvency II standards, and could not get the European Union to agree to another type of solvency oversight convention, would U.S. carriers have to pay more for reinsurance products purchased from foreign companies? If so, would U.S. carriers be reluctant to buy foreign reinsurance products that could cost more?

A.13. The United States is not contemplating application of Solvency II standards with respect to U.S. prudential insurance regulation, nor is the United States seeking to prevent the European Union from applying its solvency oversight approach within the European Union. Further, under the U.S.–EU Covered Agreement, a U.S. insurer is able to operate in the European Union without subjecting its U.S. parent to potentially costly worldwide group capital requirements (and other group supervision requirements), which may otherwise have been applicable under Solvency II. Additionally, under the U.S.–EU Covered Agreement, U.S. reinsurers are not required to establish a local EU presence in order to assume business from EU ceding insurers.

There are a number of factors that could affect the costs to U.S. ceding insurers for reinsurance obtained from assuming insurers domiciled in certain jurisdictions. In general, U.S. insurers are likely to prefer to obtain reinsurance from companies that are subject to strong and reliable prudential supervisory regimes.

The United States and the European Union remain the two largest insurance markets in the world. As FIO has noted in recent annual reports, our expectation is that these markets will continue to provide shared opportunities for organic growth. U.S. insurers will continue to find that EU-based reinsurance is an important component of their overall decisions regarding risk diversification. In that regard, U.S. insurers may seek to access a variety of risk transfer products—including domestic reinsurance, international reinsurance, or various alternatives, such as insurance-linked securities.

Q.14. Can you explain why some argue that the proposed Solvency II standards could place the U.S. insurance carriers at a disadvantage?

A.14. Various parties have expressed concern that Solvency II's market valuation approach has negative effects on the ability of insurance companies to provide long-term savings products. Parties have raised similar concerns with the current design of the ICS that is being developed by the IAIS. At the IAIS meetings in Abu Dhabi, FIO registered its official objection to the IAIS's advancement of version 2.0 of the ICS into a 5-year monitoring period. One of the reasons for FIO's objection was that the current form of the ICS could risk limiting U.S. consumers' access to important long-term savings products, which are important products to insurers and critical for the millions of Americans saving for retirement.

RESPONSE TO WRITTEN QUESTION OF SENATOR SINEMA FROM STEVEN E. SEITZ

Q.1. Under the new capital standard being developed by the International Association of Insurance Supervisors, insurance companies would be required to hold short-term assets more than, or instead of, long-term assets. If insurance companies are required to do so, will this new standard reduce the availability and affordability of annuities, which are longer-term products that provide retirement security for millions of Americans?

A.1. The International Association of Insurance Supervisors (IAIS) should continue to improve the design of the ICS so that it more appropriately reflects the business model of insurers. In particular, the IAIS should improve the ICS's market valuation approach to mitigate the negative effects it could have on the ability of insurance companies to provide long-term saving products, which are critical to millions of Americans entering retirement.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM THOMAS SULLIVAN

Q.1. Should the IAIS adjust its International Capital Standards (ICS) to comport with the structure of the U.S. insurance market prior to adoption for monitoring?

A.1. Yes, the Federal Reserve Board (Board) advocates at the International Association of Insurance Supervisors (IAIS) that the structure of the International Capital Standard (ICS) should comport with the structure of the U.S. insurance market.

Q.2. How can the operational effectiveness of ICS be properly examined if it is has identified flaws from the outset?

A.2. Under its current form, the ICS is unfit for the U.S. market. Because of this, the Federal Reserve, Department of the Treasury, National Association of Insurance Commissioners (NAIC), and the States are pressing hard to structure the monitoring period so that further work and revisions will be made.

An international standard could limit regulatory arbitrage and could help provide a level playing field for global insurers. It also could help ensure that U.S. companies are not held to unsuitable or onerous regulations when they operate abroad. This is why we remain committed to working with the IAIS to develop an international standard that works for the U.S. insurance market.

Q.3. Specifically, what adjustments to ICS would you like to see prior to its adoption?

A.3. We have concerns that the ICS currently includes a valuation method and other requirements that may not be optimal for the U.S. insurance market. Insurers generally operate with a buy-and-hold, long-term approach to investing, yet the ICS, as proposed, uses a market-based valuation method, whose volatility could ultimately reduce the availability of insurance products with long-term guarantees.

Because of these concerns, the Federal Reserve intends to continue to advocate internationally for the recognition of the Aggregation Method (AM) at the IAIS, which in its design will be foundationally similar to our domestic approach, the building block approach (BBA) and the NAIC's Group Capital Calculation. The IAIS should include a path to determine that the Aggregation Method (AM) is an outcome equivalent or "comparable" to the ICS.

RESPONSE TO WRITTEN QUESTION OF SENATOR MENENDEZ FROM THOMAS SULLIVAN

Q.1. Before the International Association of Insurance Supervisors (IAIS) votes on adoption of the new international capital standards, there will be two meetings this month and next to lay the groundwork for the annual General Meeting in November.

How will each of you approach these meetings and what outcomes do you hope to achieve?

A.1. In each of these meetings, the Federal Reserve will collaborate with the States, National Association of Insurance Commissioners, and Federal Insurance Office to advocate for the best interests of the U.S. insurance market. Collectively, we have concerns with several aspects of the International Capital Standard (ICS), including the ICS's market-based valuation approach and the standard for assessing the comparability of the Aggregation Method. We plan to raise these issues at each meeting until there is agreement on how to proceed. It is our intention to achieve a suitable agreement that addresses our concerns and recognizes the U.S. regulatory system.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM THOMAS SULLIVAN

Q.1. In your view, does the capital framework that exists as part of the U.S. State-based insurance regulatory regime provide similar protections as the proposed ICS Version 2.0 standard?

A.1. Currently, the U.S. regulatory regime does not include group-level capital requirements. The Federal Reserve Board (Board) has proposed applying a building block approach (BBA) to the insurers we supervise domestically. We believe an approach like the BBA, domestically, in the form of the Aggregation Method (AM), internationally, will provide a comparable outcome to the protections in the International Capital Standards 2.0 for the groups to which it would be applied.

Q.2.a. In response to questions from Senator Brown during your oral testimony, you indicated that supported FSOC's de-designation of insurance companies, meaning that you did not believe that any insurance companies in the United States today would pose a risk to the broader economy in the event they experienced material financial distress.

Do you believe that American International Group, Inc., Prudential Financial, Inc., and MetLife, Inc. have reduced their risk profiles sufficiently since the financial crisis?

A.2.a. The financial crisis showed that the distress of large and systemic nonbank financial companies could imperil the financial stability of the United States, ultimately putting the American economy at risk. The Dodd-Frank Wall Street Reform and Consumer Protection Act gave regulators new tools to address this problem, and in 2013, the Financial Stability Oversight Council (FSOC) acted to designate AIG, Prudential, and MetLife for additional supervisory measures.

Since the financial crisis, AIG has largely sold off or wound down its capital markets businesses, and has become a smaller firm that poses less of a threat to financial stability. For example, it has reduced its assets by more than $350 billion, wound down its Financial Products division, and sold off its mortgage insurance company.

The October 2018 decision to rescind Prudential's designation was based upon the FSOC's reevaluation of the risks posed by the firm. The FSOC examined the potential for policyholders to withdraw cash or surrender their policies from Prudential in the event the company experienced material financial distress and concluded that a forced liquidation of assets by Prudential to account for policyholder withdrawals should not be large enough to impair overall market functioning or impact the macroeconomy, although it could pose challenges to certain market participants.

In March 2016, the U.S. District Court overturned the FSOC's determination that MetLife poses a threat to U.S. financial stability. The Government subsequently appealed the District Court's decision. In January 2018, the FSOC and MetLife filed a joint motion to dismiss the FSOC's appeal, which was accepted by the U.S. Court of Appeals. It should be noted that, in the summer of 2017, MetLife shrank substantially by spinning off a portion of its U.S. retail life insurance and annuity segment into Brighthouse Financial.

It is important to continue to monitor large nonbank financial firms to ensure that, should they encounter distress, the functioning of the broader economy is not threatened. The possibility of de-designation provides an incentive for designated firms to significantly reduce their systemic footprint.

Q.2.b. Should an insurance company's overall risk profile, including their interconnectedness to other institutions and overall leverage exposure no longer be considered when determining the appropriate regulatory tools?

A.2.b. The Board is not the primary regulator for insurance companies and thus not responsible for establishing the regulations to which they are subject.

Q.2.c. Under an activities-based approach, how would regulators proactively identify activities that insurance companies engage in that are risky and prevent firms from restructuring or renaming those activities?

A.2.c. FSOC's proposed nonbank guidance promotes an activities-based approach for identifying and mitigating risks to financial stability. However, it also maintains the tool of designating individual entities as systemically important in cases where the activities-based approach is either inappropriate or insufficient.

The guidance represents a framework that addresses financial stability risks that either would not be mitigated by designating the largest market participants or would be more efficiently mitigated by directly targeting the risky activity. FSOC's monitoring of activities will look for activities that may generate leverage, interconnectedness, or run risk and that can generate significant spillovers to the economy. In the case of insurance companies, for example, it will be important to focus on products that offer protection and wealth accumulation that could be withdrawn at the discretion of the policyholder, such as Guaranteed Interest Contracts that generated runs in the 1990s.[1]

It is important to note that we view the activities-based approach described in the proposed amended guidance as a complement to entity designations rather than as a substitute for the current entity-based approach of managing systemic risk. Individual nonbank entities can pose systemic risks, and we believe that it is critical that FSOC maintains the option to designate these firms when appropriate.

Q.3. On September 6, 2019, the Federal Reserve issued a Notice of Proposed Rulemaking (NPR) that described a building block approach (BBA) that builds on existing State-based insurance standards. This approach would result in capital requirements for insurance companies that own a depository institution.[2] Does the Federal Reserve view the capital standard as a tool primarily for providing stability of the insurance industry within the financial system, providing protection to holders of insurance policies, or both?

A.3. By helping to prevent insolvencies, the BBA would protect the U.S. system of deposit insurance and promote financial stability. This compliments the work of State insurance regulators to protect policyholders.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SASSE FROM THOMAS SULLIVAN

Q.1. I understand that the International Capital Standard (ICS) produced by the International Association of Insurance Supervisors (IAIS) is nonbinding to U.S. insurers until it is either adopted by regulators or enacted into law by Congress.

- Could you discuss the potential ramifications on U.S. insurers operating in markets abroad even if the standards produced through IAIS are nonbinding on U.S. insurers?
- What disadvantages or repercussions could our insurers at home in the United States face?

A.1. The International Capital Standard (ICS) is considered a group capital standard. U.S. insurers operating in foreign markets that have adopted the ICS would likely be expected by their foreign regulators to be capitalized at the group level based on the ICS. If

[1] Like bank CDs, the money invested in these life insurance contracts can generally be withdrawn at the option of the policyholder and is therefore subject to runs.

[2] Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on proposal to establish capital requirements for certain insurance companies supervised by the Board," *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190906a.htm.*

the company is not using the ICS for the entire group (including its U.S. business), the local foreign regulators could potentially subject the firm to enhanced supervisory requirements.

The Federal Reserve, along with the U.S. Department of the Treasury, National Association of Insurance Commissioners, and the States remain committed to working with the International Association of Insurance Supervisors IAIS to develop an international standard that is appropriate for the U.S. insurance market.

An international standard like the ICS could limit regulatory arbitrage and could help provide a level playing field for global insurers. It could also help ensure that U.S. companies are not held to unsuitable or onerous regulations when they operate abroad.

Q.2. The United States represents over 40 percent of the world's insurance market and has one of the most robust, well-developed insurance regulatory systems in the world. One which both protects consumers and but also encourages competition and innovation. With this in mind, the Federal Reserve in January of this year at a round table stated that it would "continue to advocate for international insurance standards that promote a global level playing field and work well for the U.S. insurance market".

Q.2.a. Is the U.S. insurance industry well-regulated and protecting consumers today?

A.2.a. The United States has the largest insurance market in the world[1] and routinely receives high marks for supervision in assessments by third parties.

Q.2.b. If yes, what is ICS solving for since the ICS as proposed would disadvantage U.S. insurers?

A.2.b. An appropriate international standard could limit regulatory arbitrage and help provide a level playing field for internationally active insurance groups. An appropriate international standard could also help to ensure that internationally active U.S. companies are not held to unsuitable and onerous standards when they operate in foreign countries. Additionally, it could reduce risk to U.S. consumers by ensuring that foreign insurers operating within the United States are held to appropriate capital regulation by their foreign group-wide supervisor.

Q.3. In May of this year, a group of bipartisan Senators, including myself, sent a letter to Vice Chairman Quarles on this particular topic. In this letter we stated that we believe "the Financial Stability Board (FSB) should publicly state that aggregation approaches to group capital as well as other well-developed and proven jurisdictional capital regimes are acceptable methodologies for assessing group capital adequacy".

If the Fed and NAIC through their respective proposals, the Building Block Approach (BBA) and the Group Capital Calculation, are unsuccessful in having one of these accepted by the IAIS both of which are more compatible to the U.S. insurance structure, what are the next steps that Team USA need to take to ensure that our

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[1] See *https://www.treasury.gov/resource-center/international/Documents/cr1590.pdf* and *https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2019_FIO_Annual_Report.pdf.*

U.S. insurance companies are not placed on an uneven playing field?

A.3. The Federal Reserve intends to continue to advocate internationally for the recognition of the Aggregation Method (AM) at the IAIS, which in its design will be foundationally similar to our domestic approach, the building block approach (BBA) and the NAIC's Group Capital Calculation. Because of the concerns regarding the current design of the ICS, U.S. members also support continued development of the ICS to accommodate design changes during the monitoring period.

Q.4. You serve in the FSB and have inside knowledge about how the process for the ICS is being developed and where the IAIS's mindset is. Can you explain why they will not make this commitment to the United States?

Why should U.S. insurers go through this process with a group that does not show sufficient consideration of U.S. interests?

A.4. The Federal Reserve believes that it is in our national interest to engage in the international insurance standards-development process so that it produces standards that are appropriate for the U.S. market and U.S. consumers when foreign insurers operate here and are suitable for U.S. companies operating abroad. Without engagement, even less consideration would be given to U.S. interests in the development of international standards. Furthermore, the ICS, or any standard produced by the IAIS, is a voluntary standard that is not binding and would need to be adopted voluntarily by each member jurisdiction in accordance with applicable domestic laws.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM THOMAS SULLIVAN

Q.1. How could insurance companies pose a threat to U.S. financial stability?

A.1. Many observers have argued that insurers do not pose systemic risks because such entities have longer-term liabilities than banks and are immune to a large influx of demands for funds over a short period of time or "runs." However, history shows that there are several examples of runs on large insurance companies that threatened the broader financial system and the U.S. economy.

Insurance products were run upon during the Great Depression, leading to withdrawals on certain products being suspended.[1] The runs on Executive Life in April 1991, followed by those on First Capital Life in May 1991 and Mutual Benefit in July 1991, were tied to products that offer protection and wealth accumulation that could be withdrawn at the discretion of the policyholder, such as Guaranteed Interest Contracts.[2]

More recently, the near-collapse of AIG during the financial crisis showed that the distress of a large and systemic insurance company could imperil the financial stability of the United States, ultimately putting the American economy at risk.

[1] *See* "Insurance concerns tighten loan rules," New York Times, March 9, 1933, p. 6.

[2] Similar to bank CDs, the money invested in these life insurance contracts could generally be withdrawn at the option of the policyholder and was therefore subject to runs.

Insurance companies can also pose risks to the financial system through their role as intermediaries with other parts of the financial system. Among other things, they play a major role in lending to nonfinancial companies and in the market for commercial real estate financing. For this reason, liquidity problems at life insurance companies can have serious implications for financial markets and the broader economy.

Q.2. How frequently in the past 15 years did property and casualty or life insurers become insolvent? How many of the claims to insolvent firms were not covered? How many of the claims to insolvent firms were covered by the Guarantee Associations?

A.2. Over 200 licensed insurance companies became insolvent between 2000 and 2017. Guarantee associations covered most of the cost of these insolvencies, but these guarantees are restricted by policy type and coverage limit.

Q.3. Are there any insurance companies now—either from their nature, scope, size, scale, concentration, interconnectedness, or mix of activities—that could pose a threat to U.S. financial stability? If yes, what do you recommend we do about these potential threats?

A.3. The financial crisis showed that the distress of large and systemic nonbank financial companies could imperil the financial stability of the United States, ultimately putting the American economy at risk, as noted above. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) gave regulators new tools to address this problem and in 2013, the Financial Stability Oversight Council (FSOC) moved to designate AIG, Prudential, and MetLife for additional supervisory measures.

Since then, reflecting changes in size and business activities of AIG, and a re-evaluation of the risks posed by Prudential, FSOC has rescinded the designation of these firms.[3]

In March 2016, the U.S. District Court overturned the FSOC's determination that MetLife poses a threat to U.S. financial stability. The Government subsequently appealed the District Court's decision. In January 2018, FSOC and MetLife filed a joint motion to dismiss FSOC' s appeal, which was accepted by the U.S. Court of Appeals. It should be noted that in the summer of 2017, MetLife shrank substantially by spinning off a portion of its U.S. retail life insurance and annuity segment into Brighthouse Financial.

It is important for the FSOC to continue to monitor large nonbank financial firms to ensure that, should such firms encounter distress, the functioning of the broader economy is not threatened. The possibility of de-designation provides an incentive for designated firms to significantly reduce their systemic footprint.

Q.4. The International Association of Insurance Supervisors (IAIS) approved its 2020–2024 Strategic Plan this summer. It also included cyber resilience and climate risk. Can you tell me more about the goals the IAIS has to reduce risks related to cyber-attacks and climate change?

[3] The Financial Stability—Oversight Council rescinded the designations on Prudential and AIG in October 2018 and September 2017, respectively, (see *https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx* for additional detail).

A.4. The International Association of Insurance Supervisors (IAIS) regards both cyber risk and risks from climate change as important emerging risks and has prioritized these, along with fintech and other issues, in its strategic plan. The IAIS has set up high-level groups on these topics. The groups will explore these risks, propose any needed revisions to IAIS standards, and produce materials that will help supervisors to mitigate these risks.

Q.5. What investment strategies are insurance carriers taking in relation to climate risk versus what new policies options or restrictions are becoming prevalent to address climate change?

A.5. U.S. insurance companies have responded to climate risk in various ways, including—by implementing policies that incorporate Environmental, Social, and Corporate Governance (ESG) factors into their investment strategies. Many large insurers also produce an annual sustainability report.

Q.6. How are different nations requiring insurance firms to consider the impacts of climate change?

A.6. Regulators in most jurisdictions have not introduced new requirements for insurance firms related to the impacts of climate change. However, as with any emerging risk, regulators expect firms to include risks related to climate change in their risk identification and risk management activities, and expect boards to question management about the firm's exposure to climate risk.

Q.7. The International Association of Insurance Supervisors (IAIS) is working to evaluate the use of financial technology and insurance. Can you tell me more about issues related to artificial intelligence, the use of algorithms, and data privacy?

A.7. The IAIS formed a FinTech Forum (Forum) in 2018 to study the possible impact of new technology to the insurance sector. The Forum meets approximately six times per year to present on various topics including artificial intelligence, distributed ledger technology, and other possible emerging risks.

The Forum aggregates data from many jurisdictions to understand and assess how these risks are identified, monitored, reported, and controlled. If necessary, risks are escalated to the IAIS Executive Committee for better understanding of how the Insurance Core Principles may apply.

Q.8. How do you monitor the property and casualty insurance companies to ensure fintech and insurtech innovations do not lead to discrimination? How do you ensure compliance with the Fair Housing Act?

A.8. The important aspects of the actual business of providing insurance are the province of the relevant State insurance supervisors. The Federal Reserve does not regulate the manner in which property and casualty insurance is provided by supervised institutions or the types of insurance that they provide.

The Federal Reserve does supervise all State member banks for compliance with the Fair Housing Act, which prohibits discrimination in residential real-estate-related transactions, including the making and purchasing of mortgage loans—on the basis of race, color, religion, sex, handicap, familial status, or national origin. Our fair lending supervision program includes review of fintech practices to ensure that the financial institutions under our jurisdiction fully comply with applicable Federal consumer protection laws and regulations.

Q.9. The Nevada Insurance Commissioner told me that the Covered Agreement standards were developed using banking capital standards, rather than insurance capital standards.

Can you explain the difference between the controls that banks have in place versus the controls that insurers have in place? I'm specifically interested in the use of the reinsurance tools that insurance carriers have available to them that banking systems do not.

A.9. A Covered Agreement is an agreement authorized by the Title V of the Dodd-Frank Act related to the recognition of insurance prudential standards. The Secretary of the Treasury and U.S. Trade Representative must approve covered agreements, and these agencies led the negotiation of the U.S.–EU Covered Agreement.

The U.S.–EU Covered Agreement does not require applying banking capital standards to insurers. The U.S.–EU Covered Agreement was negotiated in consultation with State insurance regulators and reflects insurance-centric concepts.

Q.10. Do you think that the international insurance supervisors who focus on insurance capital standards are open to alter their oversight standards to be considered "substantially similar" to the U.S. standards?

A.10. The United States has the largest insurance market in the world [4] and routinely receives high marks for supervision in assessments by third parties. Most other jurisdictions aspire to having substantially similar protections as the U.S. market. Many jurisdictions are, however, committed to their current approach to assessing insurance capital and would like to avoid significant changes.

Q.11. The European Union established Solvency II. Can you describe how the Minimum Capital Requirements work? What is considered? What happens when an insurance company falls below the Minimum Capital Requirements?

A.11. Under Solvency II, the Minimum Capital Requirement (MCR) represents the capital needed to cover (based on an 85 percent confidence interval) the variation over 1 year in the company's "basic own funds" (roughly equivalent to shareholders' equity). The MCR considers variation that arises from insurance underwriting risk, market risk, counterparty default risk, and operational risk. If a company's capital position falls below the MCR, the supervisor may put the company into receivership, require it to stop selling new business, and/or revoke its insurance license. There is a higher level, called the Solvency Capital Requirement (SCR) which is calibrated to a 99.5 percent confidence level. Firms subject to Solvency II typically manage to a level above the SCR and supervisors typically view the SCR as the first point of supervisory intervention.

Q.12. Solvency II has three pillars. Pillar 3 requires insurers file annual reports with their regulator and make them available to the

[4] See *https://www.treasury.gov/resource-center/internationa/Documents/cr1590.pdf* and *https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2019_FIO_Annual_Report.pdf.*

public. Have you had any feedback from the public based on one of those reports?

A.12. At this time, we have not been contacted with feedback on Solvency II disclosures.

Q.13. If the United States did not agree to use the same Solvency II standards, and could not get the European Union to agree to another type of solvency oversight convention, would U.S. carriers have to pay more for reinsurance products purchased from foreign companies? If so, would U.S. carriers be reluctant to buy foreign reinsurance products that could cost more?

A.13. This scenario would be a continuation of the status quo and, by itself, would not lead to an increase in reinsurance premiums.

Q.14. Can you explain why some argue that the proposed Solvency II standards could place the U.S. insurance carriers at a disadvantage?

A.14. Solvency II is the regulatory framework applied to insurers who operate in the European Union (EU). Foreign subsidiaries of U.S. insurance carriers operating in the European Union are subject to Solvency II just as subsidiaries of foreign insurers operating in the United States are subject to the State Risk-Based Capital framework applicable in the U.S. Solvency II is a group capital standard. Since the United States does not currently have a group capital standard, it is possible that foreign regulators could subject the EU-based subsidiaries of U.S. insurance carriers to enhanced supervisory requirements unless the terms of the Covered Agreement are met.

RESPONSE TO WRITTEN QUESTION OF SENATOR SINEMA FROM THOMAS SULLIVAN

Q.1. Under the new capital standard being developed by the International Association of Insurance Supervisors, insurance companies would be required to hold short-term assets more than, or instead of, long-term assets. If insurance companies are required to do so, will this new standard reduce the availability and affordability of annuities, which are longer-term products that provide retirement security for millions of Americans?

A.1. Under its current form, the International Capital Standard (ICS) is unfit for the U.S. insurance market, and the Federal Reserve is advocating at the International Association of Insurance Supervisors that the structure of the ICS should comport with the structure of the U.S. insurance market. Adopting the ICS as it is currently construed would result in capital requirements for longer duration products, like annuities, that are higher than current requirements. This would likely increase the cost of offering these products. The higher cost could result in reduced interest by companies in offering these products and/or higher costs for these products for consumers.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM ERIC A. CIOPPA

Q.1. Should the IAIS adjust its International Capital Standards (ICS) to comport with the structure of the U.S. insurance market prior to adoption for monitoring?

A.1. As an international standard-setting body, the IAIS needs to accommodate the diversity of practices across the globe, and particularly as it regards the United States, one of the largest and strongly supervised and tested insurance markets in the world. We are disappointed at the current state of the ICS discussions. The NAIC believes that the IAIS should provide a clear path forward in assessing whether the Aggregation Method (AM) provides comparable outcomes to the ICS prior to the adoption of the ICS for monitoring. We hope the IAIS will develop a definition and overarching guidelines for the comparability assessment between the reference ICS and the Aggregation Method by the time of the IAIS Annual Meeting in Abu Dhabi that will provide us with the certainty we require.

Q.2. How can the operational effectiveness of ICS be properly examined if it is has identified flaws from the outset?

A.2. The IAIS is in its fifth year of field testing the ICS. This process will continue through a 5-year Monitoring Period. The NAIC and the other IAIS Members will continue to review the financial results submitted during the Monitoring Period. These findings will inform our opinions on the appropriateness of the ICS and changes that may need to be made. We are encouraging the IAIS to perform reasonableness checks of the results against a number of benchmarks and perspectives. Whether analysis and monitoring leads to rectifying the inherent flaws in the ICS remains to be seen, but we have stressed that the monitoring period should be approached with an open mind and as an opportunity to fix those flaws.

Q.3. Specifically, what adjustments to ICS would you like to see prior to its adoption?

A.3. The ICS has largely been modeled on Solvency II, which has a different valuation and architecture than our U.S. capital framework. It is difficult to merely tweak the ICS in order to make it work well in our U.S. system. Thus, we would like to see changes in the ICS that allow for more jurisdictional flexibility and national discretion in its implementation.

In terms of specific adjustments, we would like to see changes to the criteria for recognition of capital financial instruments. While some positive movement has been made to recognize surplus notes for mutual insurers and structural subordination of debt, there are still significant issues in allowing elements of senior debt recognized as capital resources.

Another area where we would like to see adjustments relates to the treatment of margins over current estimates in reserves. The margins we use in the U.S. reserving methodology, together with capital, jointly aim to provide for severely adverse scenarios whereas the IAIS wishes to add additional margins even after a severely adverse scenario has been addressed through a capital requirement. We think that other elements of our regulatory framework are available to help ensure policyholders are paid should capital be depleted.

Finally, as it relates to matching assets to liabilities, our approach supports suitably stressed liabilities over the lifetime of the liability portfolio with assets that include future premiums and reinvestment of proceeds rather than the ICS's approach of a year-by-year matching with no carry forward of surplus assets that have previously been accumulated over the early years of the cash-flow testing. In this case, the ICS is in conflict with the way U.S. insurance firms actually manage their business and may create disincentives to offer certain types of products.

RESPONSE TO WRITTEN QUESTION OF SENATOR MENENDEZ FROM ERIC A. CIOPPA

Q.1. Before the International Association of Insurance Supervisors (IAIS) votes on adoption of the new international capital standards, there will be two meetings this month and next to lay the groundwork for the annual General Meeting in November.

How will each of you approach these meetings and what outcomes do you hope to achieve?

A.1. We are working with our Team USA colleagues to provide joint views on the issues both in advance of and during the meetings. We have also been reaching out to other jurisdictions to share our perspective and obtain a better understanding of views and possible ways forward. The outcome we hope to achieve is a clear path forward for assessing the comparability of the Aggregation Method and for changes to the reference ICS.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM ERIC A. CIOPPA

Q.1. The increasing prevalence of big data, artificial intelligence, and new innovations in financial technology have wide-reaching implications for the insurance industry.

Q.1.a.i. In response to these trends, NAIC created a Big Data (EX) Working Group. On the NAIC webpage for the group, there are three "2019 Charges" listed. One of these charges is to "review current regulatory frameworks used to oversee insurers' use of consumer and non-insurance data. If appropriate, recommend modifications to model laws and/or regulations regarding marketing, rating, underwriting and claims, regulation of data vendors and brokers, regulatory reporting requirements, and consumer disclosure requirements."[1]

- When does NAIC anticipate completing that review?

A.1.a.i. The discussions of the Big Data Working Group will continue into 2020 and will likely extend beyond next year as the practices of insurance companies and producers continually evolve. The working group continues to focus on marketplace practices of both data vendors and insurance companies across multiple lines of authority and multiple business functions. These include rating, underwriting, marketing, and claims settlement.

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[1] National Association of Insurance Commissioners, "Big Data (Ex) Working Group," *https://naic-cms.org/cmte_ex_bdwg.htm.*

Arising out of these broader discussions, other NAIC committees are also focusing on related issues. The NAIC's Accelerated Underwriting Working Group is considering the use of external data and data analytics in accelerated life underwriting and, if appropriate will draft guidance for States. They plan to complete this work by the NAIC's November 2020 national meeting. A new Privacy Protections Working Group was formed in October 2019 and is directed to complete its work by the August 2020 national meeting. The working group is reviewing State insurance privacy protections regarding the collection, use, and disclosure of information gathered in connection with insurance transactions. If necessary, they will make changes to certain NAIC models, such as the NAIC Insurance Information and Privacy Protection Model Act (#670) and the Privacy of Consumer Financial and Health Information Model Regulation (#672). Finally, the Casualty Actuarial and Statistical Task Force is completing a white paper on regulatory best practices for the review of predictive models and analytics filed by insurers to justify rates and provide guidance for the review of rate filings based on predictive models. This white paper should be completed in 2020.

Q.1.a.ii. Upon completion, does NAIC intend on making its findings and recommendations public?

A.1.a.ii. Yes, the NAIC is committed to conducting its business openly and transparently. NAIC discussions about the formation of its findings are open to the public and all final findings and recommendations will also be available to the public.

Q.1.b. What efforts are being taken at NAIC to promote transparency among insurers with respect to the type of data they obtain from their consumers?

A.1.b. A new Privacy Protections Working Group is reviewing State insurance privacy protections regarding the collection, use, and disclosure of information gathered in connection with insurance transactions and, if necessary, make recommended changes to certain NAIC models, such as the NAIC Insurance Information and Privacy Protection Model Act (#670) and the Privacy of Consumer Financial and Health Information Model Regulation (#672). To support these efforts, there has been extensive research on State data privacy legislation to identify existing State notice and disclosure requirements.

Q.1.c. What efforts are being taken to ensure that the algorithms insurers use in their underwriting procedures are not producing discriminatory results?

A.1.c. For property and casualty insurance, the Casualty Actuarial and Statistical Task Force is completing a white paper on regulatory best practices for the review of predictive models and analytics filed by insures to justify rates and provide guidance for the review of rate filings based on predictive models. To support State insurance regulators in their review of rate filings, the NAIC will be offering additional assistance for the technical review of filings to help document information needed for State insurance regulators to make decisions about unfair discrimination. For life insurance, the Accelerated Underwriting Working Group is considering the use of external data and data analytics in accelerated life underwriting and, if appropriate, will draft guidance for States.

Q.2. In 2010, the NAIC adopted the Insurer Climate Risk Disclosure Survey to help better understand how climate change is impacting the insurance industry.[2]

Q.2.a. How has NAIC used the results of that survey and other research to establish standards and best practices for insurance companies with respect to climate change risk?

A.2.a. The NAIC Climate Risk Disclosure Survey collects information from more than 1,000 insurers capturing more than 70 percent of the U.S. insurance market and provides insurance regulators with useful insight regulators identify trends, vulnerabilities, and industry best practices. Some of these best practices go into how insurers assess and manage climate risks. It helps practices include engaging policyholders to reduce climate-related risks, including monetary incentives for mitigation and resiliency efforts; investing in modeling and analytics to better evaluate the impact of climate variables; and partnering with organizations to improve sustainable infrastructure to help reduce exposure to climate risks. In addition to the survey, the NAIC developed guidance for financial examiners on assessing an insurer's climate risks and the impact on how the insurer invests its assets and prices its products. The NAIC also incorporated a catastrophe risk charge into the property and casualty Risk-Based Capital formula to help ensure insurers hold enough capital to remain solvent in the face of extreme weather events. Climate risk and resiliency remains one of the NAIC's strategic priorities and we are pursuing initiatives through our Catastrophe Insurance Working Group and Climate Risk and Resiliency Working Group to improve sustainability and enhance mitigation efforts. We are also working to develop a centralized location for the collection and sharing of States' resilience-related resources and activities.

Q.2.b. What are some of the best practices described in the survey related to insurers' responses to climate change?

A.2.b. The following are some of the best practices described by insurers in the survey responses:

- Incorporate climate risk into comprehensive enterprise-risk management.
- Diversify climate-related risks on both sides of the balance sheet.
- Embed sustainability and climate risk into corporate leadership.
- Build a culture of sustainability throughout the company by setting, measuring, and rewarding sustainability priorities.
- Align climate risk-related goals with business strategy.
- Invest in modeling and analytics to better evaluate the impact of climate variables on a micro and macro level.

[2] National Association of Insurance Commissioners, "Climate Risk Disclosure," *https://www.naic.org/cipr_topics/topic_climate_risk_disclosure.htm.*

- Engage policyholders to reduce climate-related risks, including monetary incentives for resilience measures and education.
- Engage key constituencies on climate change, including membership/funding/participation in research, education and advocacy organizations, such as the Build Strong Coalition, Institute for Building and Home Safety (IBHS), international associations/initiatives and trade organizations.
- Build partnerships to support resilience efforts. Some examples include Travelers Insurance's partnership with IBHS to help Habitat for Humanity build more resilient homes in coastal communities; United Services Automobile Association's partnership with Colorado Springs Fire Department and the nonprofit FIREWISE Organization to underscore the importance of fuel reductions and fire mitigation for homeowners and USAA's sponsorship of Wildfire Partners, a public-private partnership mitigation program to help homeowners prepare for wildfire.

Q.2.c. Based on the survey and your interactions with various stakeholders at the State level, what conclusions has NAIC drawn regarding the impact of climate change on the affordability and availability of insurance?

A.2.c. The Climate Risk Disclosure Survey is intended to provide insurance regulators with a window into how insurers assess and manage climate risks. It is not specifically designed to measure the impact of climate change on affordability and availability of insurance. However, we recognize that the affordability and availability of insurance is highly reflective of local market, economic, regulatory, and exposure characteristics and can vary widely by line of business.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SASSE FROM ERIC A. CIOPPA

Q.1. I understand that the International Capital Standard (ICS) produced by the International Association of Insurance Supervisors (IAIS) is nonbinding to U.S. insurers until it is either adopted by regulators or enacted into law by Congress.

- Could you discuss the potential ramifications on U.S. insurers operating in markets abroad even if the standards produced through IAIS are nonbinding on U.S. insurers?
- What disadvantages or repercussions could our insurers at home in the United States face?

A.1. As noted, IAIS standards are nonbinding on all IAIS members and not effective until they are implemented in each jurisdiction. However, a number of jurisdictions have already indicated that they intend to implement the ICS in their local markets. Subsidiaries of U.S. insurers operating in those markets would be required to comply with those local requirements potentially including the ICS. In theory, these insurers could be required to hold more capital than is necessary on a worldwide basis, which might discourage their offering long-term products such as annuities that help individuals better plan for retirement.

Q.2. The United States represents over 40 percent of the world's insurance market and has one of the most robust, well-developed insurance regulatory systems in the world. One which both protects consumers, but also encourages competition and innovation. With this in mind, the Federal Reserve in January of this year at a round table stated that it would "continue to advocate for international insurance standards that promote a global level playing field and work well for the U.S. insurance market."

Q.2.a. Is the U.S. insurance industry well-regulated and protecting consumers today?

Q.2.b. If yes, what is ICS solving for since the ICS as proposed would disadvantage U.S. insurers?

A.2.a.–b. Yes, the U.S. insurance sector is well-regulated and protects consumers today. The primary purpose of the ICS is to ensure that there is sufficient regulation of the group capital position of Internationally Active Insurance Groups. A U.S.-based IAIG, by definition, does at least 10 percent of its business outside the United States. Given the unique challenges of regulating such groups, we can understand the IAIS's desire to develop a capital standard for IAIG's. Our objections have been to the form that the ICS has taken on and not the concept of an ICS. A suitable principles-based (as opposed to prescriptive) standard that allows regulators to build on our existing regulatory tools would be welcome. Unfortunately, that is not the ICS that is being proposed. In the United States, there are already numerous tools available for group analysis and another one—the Group Capital Calculation (GCC)—is being developed. We believe that the GCC should be recognized as jurisdictional alternatives to the ICS.

Q.3. As I understand, the United States is the largest insurance market in the world with over 40 percent of the world's insurance premiums. One of the messages that I have heard from stakeholders is the importance for the IAIS to recognize the U.S. system of insurance regulation.

Given that the United States is one of the most well-regulated and developed insurance marketplaces in the world, why are we asking for a multilateral standard-setting body and other countries to recognize the U.S. system?

A.3. Some U.S. insurers operate in other countries. It is important that those countries recognize relevant aspects of our system to ensure that U.S. insurers operating abroad are not subject to additional requirements in the jurisdictions in which they operate.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM ERIC A. CIOPPA

Q.1. How could insurance companies pose a threat to U.S. financial stability?

A.1. It is highly unlikely that an insurance company today could pose a threat to U.S. financial stability given the insurance business model and its regulation. Property & Casualty companies and health insurance companies' businesses are not correlated with broader financial markets. Life insurers do hold investments to back their life insurance liabilities. However, regulators require life insurers to engage in asset/liability duration matching and those investments tend to be long dated. Further, life insurance liabilities are fairly sticky, and therefore, do not present significant asset liquidation risk. By way of comparison, a bank's liabilities assets and liabilities are, by virtue of the business model, mismatched and deposits can be withdrawn on demand.

We did learn from AIG that affiliates of more traditional insurers could pose threats to financial stability. To address these potential risks, State insurance regulators enhanced its group supervisory framework by providing regulators more authorities to identify and address risks within a group outside the insurance legal entities.

In addition, while it is unlikely that legal entity insurers could pose a threat to financial stability, like other financial firms, it is possible that in a stressed economic environment, the insurance sector's activities, particularly its investment activities, could have additive effects to the stresses depending on the conditions and the investments at issue. The NAIC has launched a Macroprudential Initiative (MPI) designed to identify and address any broader risks within the insurance sector. Currently, as part of this initiative, insurance regulators are developing a Liquidity Stress test framework for large life insurers. We also believe FSOC's proposed activities-based approaches is particularly suited to address potential systemic risks within the insurance sector or across the financial system. Like our MPI, it focuses on identifying risks and addressing risks in a more holistic manner than the entity-based approach, which focuses on a small set of individual firms.

Q.2. How frequently in the past 15 years did property and casualty or life insurers become insolvent? How many of the claims to insolvent firms were not covered? How many of the claims to insolvent firms were covered by the Guarantee Associations?

A.2. According to the NAIC's Global Receivership Information Data base (GRID), which is a voluntary reporting database for States, of the approximately 6,000 insurers that operate in the United States at any given time, 220 property/casualty/title insurance and 110 life/health insurance legal entities entered receivership for the 15-year period between 2004 and 2018.

In the State insurance regulatory framework, a receivership is triggered when a company becomes impaired or insolvent. However, the term receivership includes liquidation, which means the company is no longer viable and is being liquidated, as well as conservation and rehabilitation actions, in which the receiver of the company, usually the commissioner, works to assist the company in improving its financial status. Only a liquidation with a finding of insolvency triggers guaranty fund coverage. Most insolvent companies retain sufficient assets to fund a significant portion of their policyholder obligations. Other healthy insurance companies fill the gap between the failed insurer's assets and guaranty association protection levels. Historical information on company assessments can be found on the National Organization of Life and Health Insurance Guaranty Associations and National Conference of Insurance Guaranty Funds websites.[1]

[1] See *https://www.ncigf.org/industry/guaranty-fund-assessment-liability-information/* and *https://www.nolhga.com/resource/file/capacity/R1.pdf.*

The NAIC does not have information regarding the claims of insolvent insurers. However, I understand from the guaranty associations that in the over 40-year history of the insurance guaranty system, guaranty funds and associations have protected over 2.6 million policyholders, paid more than $30 billion in policy benefits, and guaranteed another $25 billion in insurance coverage over the course of 650+ insolvencies.

Q.3. Are there any insurance companies now—either from their nature, scope, size, scale, concentration, interconnectedness, or mix of activities—that could pose a threat to U.S. financial stability? If yes, what do you recommend we do about these potential threats?

A.3. No, I do not believe that there are currently any insurance companies that could by themselves pose a threat to the financial stability of the United States. To the extent insurance companies may be engaging in particular activities that could potentially raise concerns, I think FSOC's proposal to work with primary regulators through an activities-based approach is the appropriate means to address such risks. This approach is consistent with our own efforts to address these potential risks through our enhancements to the insurance group supervisory framework and our Macroprudential Initiative (MPI), which is designed to identify and address broader risks within the insurance sector.

Q.4. The International Association of Insurance Supervisors (IAIS) approved its 2020–2024 Strategic Plan this summer. It also included cyber resilience and climate risk. Can you tell me more about the goals the IAIS has to reduce risks related to cyber-attacks and climate change?

A.4. There is a general recognition that as the IAIS finalizes and implements its post-financial crisis related reforms (*e.g.,* Holistic Framework for Systemic Risk, Insurance Capital Standard (ICS), it will be able to pivot and devote more resources to other emerging areas, including fintech, cyber risk, climate risk, and the challenge of sustainable development. While the post crisis-related workstreams only directly impact a relatively small number of IAIS members, these emerging issues are relevant to most IAIS members, regardless of size. With regard to cyber risk, the IAIS is looking at the issue both from an enterprise cyber resilience perspective, but also in the context of cyber underwriting activities. The IAIS has published an issues paper on cyber risk in the insurance sector in 2016 and an application paper relating to the supervision of insurer cyber security in 2018. The IAIS has also formed a cyber underwriting small group to look specifically at cyber underwriting practices. In 2018, the IAIS in coordination with the Sustainable Insurance Forum (SIF) (which is a network of insurance supervisors and regulators from around the world who are working together on sustainability challenges facing the insurance sector)—published an issues paper on climate change risk to the insurance sector which addresses the different views and approaches in place.

Q.5. What investment strategies are insurance carriers taking in relation to climate risk versus what new policies options or restrictions are becoming prevalent to address climate change?

A.5. *Investment Strategies*

At this time, I am not aware of any material shifts in portfolio composition or investment strategies across the industry directly related to climate change. However, I have heard that a few insurers are making changes to their business, including their investments, to address climate risk.

Policy Options

Property and casualty insurers have indicated that they manage loss experience on weather-related exposures by use of loss control, higher pricing, deductibles, and limited coverage. Loss control activities include 1) advice to policyholders to use protective measures to protect their property from catastrophic weather-related events; 2) customer access to safety and disaster preparedness materials; and 3) financial incentives for policyholders to move covered items out of harm's way during an event.

Insurers also reported offering discounts and credits for superior construction materials used by policyholders to reduce weather-related event losses. In wind-affected States, discounts are often offered for mitigation devices/techniques, such as storm shutters, in addition to pricing incentives for higher deductibles. Several offer "Green Coverage" options for property insurance policyholders who already have green measures in place or wish to upgrade to green measures if and after a loss occurs to their property. For some, this coverage also provides the ability to replace damaged electronic equipment with environmentally friendly equipment. Property and casualty insurers also tended to support new International Code Council codes that promote sustainable building practices via industry advocacy groups.

Climate risk strategies were limited for life insurers and especially limited for health insurers (who are extremely short-tailed and have very limited asset exposure). Some health insurers reported encouraging policyholders to participate in climate conservation projects, such as prescription medication collection to reduce water contamination. Many life and health insurers acknowledged the longer-term impacts of climate change, such as disease frequency and severity, have the potential to increase claims or costs. However, they felt policyholder engagement specific to climate change was premature given the impacts are not yet fully quantified.

Q.6. How are different nations requiring insurance firms to consider the impacts of climate change?

A.6. Jurisdictions have different views and approaches to addressing climate risk. Many regulatory bodies and organizations are considering the impact of climate change and there has been an increase in the number of papers issued by regulatory bodies and organizations on climate risk. The Financial Stability Board (FSB) has a task force on Climate-Related Financial Disclosures (TCFD), with a goal of making the dangers of climate change more visible. The IAIS in coordination with the Sustainable Insurance Forum (SIF) (which as of June 2019 has 25 jurisdictions as members) published an issues paper on climate change risk to the insurance sector in 2018 and in March of 2019 the SIF conducted a global survey on TCFD Implementation within the insurance sector, gathering responses from nearly 1,200 insurers across 15 jurisdictions.

In August 2018, the European Insurance and Occupational Pensions Authority (EIOPA) received a request from the European Commission for an Opinion on Sustainability within Solvency II, with a particular focus on aspects relating to climate change mitigation. EIOPA's Opinion published September 2019 addresses the integration of climate-related risks in Solvency II Pillar I requirements. The European Commission will take the Opinion into account in the preparation of its report on Directive 2009/138/EC (Solvency II Directive), due by 1 January 2021.

The Bermuda Monetary Authority (BMA) publishes an annual "Catastrophe Risk in Bermuda" report. As Bermuda-domiciled insurers largely specialize in catastrophe reinsurance, this report includes a high-level overview of the catastrophe risk stress testing and modeling practices in Bermuda.

Japan's Financial Services Agency and the Ministry of Economy, Trade and Industry have urged businesses to voluntarily disclose the risks posed by climate change to their businesses and participate in a new alliance toward greater transparency.

It is worth noting that in the United States, the NAIC adopted the Insurer Climate Risk Disclosure Survey in 2010. The survey questions cover many of the same areas as the FSB's TCFD, including insurers' strategies and preparedness in investment, mitigation, financial solvency, carbon footprint and engagement with consumers. The results are intended to provide information relating to trends, vulnerabilities and best practices on insurers' response to climate change.

I would note there has been a noted increase in focus on sustainability strategies, particularly amongst larger insurers who must adhere to policies or regulations outside the United States. This includes establishing company executive/officer positions and internal task forces related to sustainability, incorporating assessments of changing climatic patterns in the underwriting process, improving energy efficiency, investing in renewable energies, providing insurance to underserved populations, strengthening business continuity plans, launching ESG Funds, new products offering green or hardier rebuilding upgrades and the creation of new tracking metrics.

Q.7. The International Association of Insurance Supervisors (IAIS) is working to evaluate the use of financial technology and insurance. Can you tell me more about issues related to artificial intelligence, the use of algorithms, and data privacy?

A.7. The IAIS recently formed the FinTech Forum to look at fintech developments that impact insurance and insurance supervision. The Forum's discussions are designed to raise awareness of emerging fintech technologies; share information on technical risks relevant to supervisory approaches for fintech; and engage with the financial services industry and other stakeholders on the topic of fintech. In addition, in 2018 the IAIS published an issues paper on digitalization of the insurance business model and an application paper on the use of digital technology in inclusive insurance. This year, the IAIS is expected to finalize an issues paper on use of big data analytics in insurance. Note that there are variety of other international bodies that have been active in this area including the OECD (which recently published guidance). Further, as part of the U.S.–EU Insurance Dialogue Project U.S. and EU regulators are also discussing issues surrounding Big Data and AI publishing a paper in November 2018 on developments and regulatory approaches in the United States and European Union in these areas.

The uses and benefits of data analytics, more sophisticated algorithms, and artificial intelligence are appealing to all industries and the insurance industry is no different. Insurers are leveraging these new capabilities in marketing and customer engagement, underwriting, rating, claims processing, and fraud detection. While these technological developments have the potential to improve how an insurer does business and can benefit policyholders, insurance regulators recognize the complexity of these new processes and the need to ensure they comply with State insurance laws and regulations designed to protect consumers. Some of these evolving techniques have made it challenging for insurance regulators to evaluate rating plans that incorporate complex predictive models and the NAIC's Casualty Actuarial and Statistical Task Force is developing regulatory best practices for the review of these models. We are committed to monitoring any potential for bias in insurers' algorithms used to synthesize big data. The NAIC's Innovation and Technology Task Force and Big Data Working Group are continuing to explore these regulatory issues. The NAIC also formed an Artificial Intelligence Working Group that is developing AI guiding principles for the insurance industry. With regard to data privacy, the NAIC recently formed a Privacy Protections Working Group to review State insurance privacy protections regarding the collection, use, and disclosure of information gathered in connection with insurance transactions to determine whether updates to our models are necessary.

Q.8. How do you monitor the property and casualty insurance companies to ensure fintech and insurtech innovations do not lead to discrimination? How do you ensure compliance with the Fair Housing Act?

A.8. State insurance regulators are committed to striking the appropriate balance between encouraging innovation while maintaining the strong consumer protections embedded in our regulatory system. To that end, the NAIC established a Big Data Working Group and an Innovation and Technology Task Force to facilitate greater understanding of these emerging technologies and to identify regulatory issues that may need to be addressed. Through these discussions, regulators are examining how insurers are using consumer data and what practices they have in place to prevent unfair discrimination in this changing marketplace and ensuring that we have the necessary tools to combat any unfair treatment of insurance consumers. The NAIC's Casualty Actuarial and Statistical Task Force is completing a white paper on regulatory best practices for the review of predictive models and analytics filed by insures to justify rates and provide guidance for the review of rate filings based on predictive models. To support State insurance regulators in their review of rate filings, the NAIC will be offering additional assistance for the technical review of filings to help document information needed for State insurance regulators to make decisions about unfair discrimination.

With regard to ensuring compliance with the Fair Housing Act (FHA), the U.S. Department Housing and Urban Development has sole enforcement authority over the FHA, which prohibits discrimination in housing transactions. While State insurance regulators do not have enforcement authority over the FHA, they do have authority to enforce State insurance laws prohibiting discrimination by insurance companies. Those laws typically apply not only to companies providing homeowners insurance, as addressed by the FHA, but to all insurers in the context of rating, underwriting, and other insurance practices. In fact, as early as 1946, the NAIC adopted model laws prohibiting "unfair discrimination" in property and casualty rating.[2] Today, those model laws specifically ban insurers from basing risk classification upon "race, creed, national origin or the religion of the insured."[3] Additionally, the NAIC Unfair Trade Practices Act (#880) inhibits insurers from "[r]efusing to insure, refusing to continue to insure, or limiting the amount of coverage available to an individual because of the sex, marital status, race, religion or national origin of the individual."[4]

Q.9. The Nevada Insurance Commissioner told me that the Covered Agreement standards were developed using banking capital standards, rather than insurance capital standards. Can you explain the difference between the controls that banks have in place versus the controls that insurers have in place? I'm specifically interested in the use of the reinsurance tools that insurance carriers have available to them that banking systems do not.

A.9. The 2017 Covered Agreement with the European Union, which was negotiated by the U.S. Treasury Department and the U.S. Trade Representative, requires a group capital assessment to be developed for insurance groups based in the United States. Since 2015 State insurance regulators, through the NAIC, have been working on a Group Capital calculation. Once completed, that work should satisfy the obligation under the Covered Agreement. I cannot speak to the controls banks have in place, but it is true that insurers carriers are able to utilize risk mitigations strategies, such as reinsurance, as a means of minimizing risks that could come to fruition even under the extreme scenarios that tend to be a focal point of bank capital standards.

Q.10. Do you think that the international insurance supervisors who focus on insurance capital standards are open to alter their oversight standards to be considered "substantially similar" to the U.S. standards?

A.10. As an international standard, the ICS is not binding on the States or the Federal Government, but it is the first attempt at a

[2] *See Casualty and Surety Rating Bill,* 1946 Proc. 396, 397–410; and *Fire and Inland Marine Rating Bill,* 1946 Proc. 396, 410–422. In 1963, these model laws were combined into what is now the *Property and Casualty Model Rating Law (Prior Approval Version)* (#1780), available at *https://www.naic.org/store/free/GDL-1780.pdf?4.*

[3] *See Property and Casualty Model Rating Law* (File and Use Version) (#1775) at Section 5(4)(b); *Property and Casualty Model Rating Law (Prior Approval Version) (*#1780) at Section 4C; and *Property and Casualty Model Rate and Policy Form Law Guideline* (#1776) at Section 5(4)(b), available at: *https://www.naic.org/prod_serv_model_laws.htm.*

[4] See Unfair Trade Practices Act (#880) at Section 4G(5), available at: *https://www.naic.org/store/free/MDL-880.pdf?62.*

globally harmonized approach to capital for insurance groups and many jurisdictions around the globe could consider adopting it. The NAIC has no intention of taking on board any international standard that does not fit with and add value to the U.S. State-based system of regulation. Bearing this in mind, the NAIC is trying to embed as much as possible our approach to capital regulation in the ICS. This has been difficult as elements of the ICS largely mirror a European Solvency II approach. Furthermore, we are trying to ensure that a jurisdictional alternative to the ICS that is based on a U.S. aggregation approach and compatible with the Federal Reserve's BBA and the NAIC's GCC, will be accepted as comparable. Other countries may also consider adopting an aggregation approach similar to our model; however, we are not seeking to impose our standards on any other jurisdiction. We are also seeking the necessary jurisdictional flexibility in order to minimize the risk of duplicative regulation or pressure on U.S. firms.

Q.11. The European Union established Solvency II. Can you describe how the Minimum Capital Requirements work? What is considered? What happens when an insurance company falls below the Minimum Capital Requirements?

A.11. This question is best answered by European insurance regulators, but based on my understanding, Solvency II established two intervention levels, "solvency capital requirement" (SCR) and the "minimum capital requirement" (MCR). For regulatory purposes, the SCR and MCR should be regarded as "soft" and "hard" floors, respectively.

Solvency Capital Requirement (SCR) is the (economic) capital that should be held to ensure that the insurance company can meet its obligations to policyholders and beneficiaries with certain probability and should be set to a confidence level of 99.5 percent over a 1-year period, which limits the chance of breaching that threshold to a less than one in 200 year event. Minimum Capital Requirement (MCR), represents an 85 percent confidence level instead of 99.5 percent over a 1-year period. Underlying both requirements are "market consistent principles" for the valuation of assets and liabilities. The excess of assets over liabilities (plus any recognized subordinated debt) is referred to as "own funds". Regulators begin to intervene when "own funds" fall below the SCR. If "own funds" fall below the MCR, then the Solvency II Directive provides European regulators with several options to address breaches of the MCR, including the complete withdrawal of authorization from selling new policies and forced closure of the company.

Q.12. Solvency II has three pillars. Pillar 3 requires insurers file annual reports with their regulator and make them available to the public. Have you had any feedback from the public based on one of those reports?

A.12. Again, this is best answered by European regulators, but based on my conversations with European insurers and regulators, reactions to Pillar 3 have been more positive. The Pillar 3 reporting requirements have expanded the availability of information on European insurers that is available to the public. One key piece of reporting is the "Solvency and Financial Condition Report" (SFCR) which is analogous to the NAIC Annual Statement that U.S. legal entities make available to the public.

Q.13. If the United States did not agree to use the same Solvency II standards, and could not get the European Union to agree to another type of solvency oversight convention, would U.S. carriers have to pay more for reinsurance products purchased from foreign companies? If so, would U.S. carriers be reluctant to buy foreign reinsurance products that could cost more?

A.13. Many factors influence the pricing of reinsurance including the nature of the risks being reinsured, the competitive landscape and, in certain instances, regulatory requirements. If the ICS remains as currently constructed and foreign jurisdictions adopt it or other Solvency II—like standards, it is possible that pricing could be impacted. However, it is difficult to know the extent of such impact and how U.S. ceding insurers may respond.

Q.14. Can you explain why some argue that the proposed Solvency II standards could place the U.S. insurance carriers at a disadvantage?

A.14. Based on my understanding, a few issues stand out. First, the Solvency II construct is quite volatile because of its market consistent principles which can lead to an over-reaction to short-term market movements and reduces the availability of long-term products. The life insurance business is based on buying-and-holding investments through the economic cycle. Market-based approaches provide incentives to sell investments at market lows and buy at market highs. Many U.S. retirees depend on the protections offered by long-term life insurance products with options and guarantees. We understand that the availability of these products declined as a result of the introduction of Solvency II in Europe. We would not want a similar impact on the U.S. life insurance market.

Second, Solvency II is overly complex and costly to comply with. Much of this complexity arises from attempts to address the (1) excess volatility and/or (2) overly conservative requirements. Examples of requirements designed to address excess volatility are the "matching adjustment" and "volatility adjustment" which are meant to reduce the sensitivity of long-term products to market movements. Examples of requirements meant to address conservatism include various incentives to use internal capital models instead of the Solvency II Standard formula. Internal capital models are costly for companies to create and costly for supervisors to review.

Third, Solvency II is built for different legal systems with different regulatory tools. For example, while guaranty funds are a critical component of our solvency framework in the United States, they are found in just a few European countries. Thus, the Solvency II framework has to ignore the protections that guaranty funds would otherwise provide and, instead, imposes additional regulatory requirements in their place.

RESPONSE TO WRITTEN QUESTION OF SENATOR SINEMA FROM ERIC A. CIOPPA

Q.1. Under the new capital standard being developed by the International Association of Insurance Supervisors, insurance companies would be required to hold short-term assets more than, or instead of, long-term assets. If insurance companies are required to do so, will this new standard reduce the availability and affordability of annuities, which are longer-term products that provide retirement security for millions of Americans?

A.1. The ICS, like our system, encourages asset-liability matching. However, the ICS requires higher capital requirements for investments that aren't perfectly matched to the liabilities being backed. Since it will sometimes be difficult to find investments that perfectly and precisely match long-term products with guarantees, firms will be subject to higher capital requirements. That will lead to reluctance among firms to offer these products, which are important retirement security product offerings.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

NAMIC®
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of the

National Association of Mutual Insurance Companies

to the

United States Senate

Committee on Banking, Housing and Urban Affairs

Hearing on

Developments in Global Insurance Regulatory and Supervisory Forums

September 12, 2019

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide comments to the U.S. Senate Committee on Banking, Housing, and Urban Affairs on the status of the international capital standards (ICS) under development at the International Association of Insurance Associations (IAIS).

NAMIC membership includes more than 1,400 member companies. The association supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC member companies write $268 billion in annual premiums. Our members account for 59 percent of homeowners, 46 percent of automobile, and 29 percent of the business insurance markets. Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

Introduction

Group capital has become a mainstay of the international regulatory dialogue since the 2008 financial crisis. In 2013 the international insurance standard-setting agency, the IAIS, was ostensibly directed by the G-20 and the Financial Stability Board to create an insurance group capital requirement for internationally active insurance groups with the intention that it would be applied consistently in all jurisdictions around the world. Since the beginning of this process, NAMIC has consistently and vocally argued for flexibility in the calculation of any ICS, based on the unique nature of the U.S. system of insurance regulation.

In the last six years, NAMIC has made numerous public statements, submitted multiple comment letters to, and spoken directly with, many global supervisors at the IAIS, and has worked with members of "Team USA" – a group of U.S. representatives including the National Association of Insurance Commissioners (NAIC), the Federal Reserve, and the Federal Insurance Office (FIO) – to try and move the ICS in a workable, flexible direction. Members of the U.S. domestic insurance industry and Team USA have also all echoed our view that the desired outcome of these international negotiations is to preserve the integrity and stability of the state-based U.S. insurance regulatory system so that it can operate and evolve in a manner that is effective and appropriate for our policyholders and markets.

Despite all of this, the IAIS has continued to push forward with an ICS ("ICS"/"ICS 2.0"/"reference ICS") that to comply, would require an overhaul of the U.S. system of insurance supervision including bases of accounting, corporate structure and laws, as well as other specifics of insurance regulation. In short, the IAIS is pushing for a capital requirement built in many key ways to resemble the EU's "Solvency II" regulatory regime. Solvency II does not work in the U.S. for many reasons (and is under heavy criticism in the EU), yet the IAIS is poised to move forward at their November 11 meeting in Abu Dhabi to adopt a Solvency II-based version of the ICS as a reference against which to measure the U.S. regulatory system. This would be an unacceptable result.

It is a pivotal moment in these international standard-setting discussions and a course correction is needed. However, given the seeming inability to incorporate flexibility within several key elements of the ICS over the last several years, as well as recent comments from the EU industry and its regulators[1], it is highly unlikely that any acceptable resolution of the major issues with the current ICS will be reached:

- The EU is and will continue to insist on a Market Adjusted Valuation system for calculating value (implemented just 4 years ago in the EU) while the U.S. must insist on flexibility to use Statutory Accounting (a system in use for nearly 30 years in the U.S.);
- The EU is and will continue to insist on creating a top-down consolidated approach which is completely contrary to the U.S. legal entity system requiring an aggregation, bottom-up approach to achieve consolidation of group capital;
- The EU will insist on the flexibility for their companies to follow Solvency II regulatory standards and still be in compliance with the ICS, but have not agreed to accept other countries complying in a flexible manner appropriate to their regulatory regimes;
- The EU is and will continue to insist that, despite their inflexibility on the specific components of the standard formula in ICS, EU companies should be allowed to use unique internal models because they are more precise than the ICS. This simply leaves all of the other international insurance groups in the world subject to the standard formula applied in the ICS while the EU insurance groups have a previously developed work-around that is conveniently already approved by their supervisors.

These are not the positions of reasonable minds interested in a fair resolution of the issues. Team USA has no fair opportunity to reach agreement on an ICS that will work in the U.S. with this type of thinking in Europe. If they cannot resolve these issues by the November meeting, NAMIC believes the U.S. needs to consider the reality that adoption of an international ICS may neither be possible nor desirable. It may be time to stop the debate and just say "no" to an international insurance capital standard.

The U.S. Regulatory Approach

The unique nature of the insurance regulatory system in the United States has created challenges in reaching consensus at the IAIS. To put it simply, the U.S. system has many different components that are not found in other countries. A quick survey of how the U.S.

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[1] Letter from Insurance Europe and the Pan European Insurance Forum to Valdis Dombrovskis, Vice-President, DG Financial Stability, Financial Services and Capital Markets Union, European Commission; *European insurance industry views on the global Insurance Capital Standard;* August 26, 2019.

approaches insurance regulation provides meaningful context for understanding the nature of these international standard-setting discussions.

To begin, U.S. state insurance regulators are highly focused on both solvency and market regulation. They must balance the two to ensure the insurance industry they regulate continues to be strong, secure, and stable while delivering the products and services to consumers in compliance with the laws. To meet these objectives, state insurance regulators have a significantly hands-on solvency supervisory system that includes regulatory elements and data collection requirements unlike supervisory systems found in other countries around the world. U.S. insurance regulators do not rely specifically on capital held to protect against insolvency. Instead they are far more focused on company behaviors and developments on a day-to-day basis.

All states must enact certain NAIC model laws regulating solvency to assure consistent regulation throughout the country. States failing to include specified accreditation requirements will lose certain privileges, and this loss will negatively impact insurance companies domiciled in their state. Accreditation requirements include:

- Annual and quarterly financial reporting pursuant to statutory accounting principles;
- Regular comprehensive financial examinations;
- Annual corporate governance disclosures;
- Annual enterprise risk reporting (ORSA and Enterprise Risk Reports);
- Numerous holding company reports and approvals (including validating reinsurance protection, itemizing mergers and acquisitions, approving intracompany transactions, approving extraordinary dividends, etc.);
- On-going company/group financial analysis;
- Restrictions on investments for inclusion as admitted assets;
- Monitoring of solvency ratios;
- Authority to intervene with companies in hazardous financial condition exhibited by activities other than capital weakness; and Risk-Based Capital reporting and compliance, including charges for affiliate risk, investment risk, asset risk, credit risk, market risk, underwriting/premium/reserve risk, modeled catastrophe risk, operational risk, and working on a group capital calculation as well as ladders of supervisory intervention for diminishing RBC levels below 300 percent of the RBC minimum requirement.

At the same time, U.S. state regulators are also heavily engaged in market conduct regulation to ensure consumer protection. The insurance code in all states includes authority over numerous market practices beyond rate regulation, such as underwriting, claims, and marketing practices. In addition, state laws provide regulatory authority to review and approve policy language, required provisions in all policies, and mandatory offers of certain coverages by all insurers writing some lines of insurance. All states have laws addressing the following issues:

- Underwriting issues like restrictions and notice requirements for cancellation, nonrenewal, and declination decisions, mandatory offers of coverage, and restrictions on underwriting decisions;
- Claims issues such as unfair claims practices, notice and timing requirements for investigation, payment, reservation of rights, appeal processes, and bad-faith claim handling;
- Advertising and marketing requirements including truth in advertising, anti-rebate laws, licensing of producers among others;
- Policy form approval requirements authorizing regulatory review and approval of language used in insurance policies, required language, requirements for readability of language, restrictions on use of clauses, etc.;
- Periodic and targeted market conduct examinations to assure compliance with all market regulations; and
- Customer complaint process for addressing any issue with any insurance company.

Most of the other countries active at the IAIS do not have laws requiring supervisors to perform all of these functions. The U.S. regulatory system is much more focused on evaluating and regulating the day-to-day activities of insurance companies than on specific levels of capital held. A U.S. state regulator would detect problems within a company because of this solvency and market-based scrutiny long before its capital levels would reflect problems. State regulators understand that in the event of an unexpected catastrophe or global financial crisis, no amount of capital may be able to protect insurers or their policyholders. Only high levels of oversight can keep the regulator informed of the trouble an insurer may be experiencing. A high capital requirement does not compare with the high level of oversight U.S. state regulators have over U.S. property/casualty insurance companies. While this intense oversight may not be preferred by the companies in the U.S., it is the system they have, and it is based on principles of insurance regulation in the U.S. that go well beyond capital requirements.

Further, and equally important to these supervisory tools, is the state guaranty fund system. Even in the rare event of a company insolvency the needs of the insurance policyholders are top-of-mind for regulators. State guaranty funds provide basic coverage to policyholders if their insurance company goes insolvent. The companies writing insurance in each state are assessed for the claims of those policyholders, and this is considered a cost of doing business. It is part of a process that makes the strength of solvency regulation important to all companies in each state. Most other countries that are members of IAIS do not have this feature in their regulatory environment for ultimate policyholder protection, and if they do, the costs of the systems are borne by the taxpayers, not the private sector insurance companies.

Any international group capital requirement that would not consider all the other supervisory and recovery tools available as well as data collected in the U.S. and the costs incurred by U.S. companies in complying with these regulatory requirements would create an unlevel playing field. This is why an outcome-based approach with flexibility in the process is very important to U.S. insurers and regulators.

The Current ICS Is Inconsistent With the U.S. System

In all of our discussions over the last several years with the IAIS stakeholders and Team USA, NAMIC has stressed why the ICS will not work under the U.S. system:

> **Legal Entity Corporate Structure** – The U.S. approach to insurance company supervision has always been focused on the individual legal entities from legal, accounting, and capital standpoints. Since insurance contracts are written by insurance legal entities and not insurance groups, and since the focus of U.S. regulation is the protection of the policyholders, the U.S. has always believed that the capital must be held at the level of the company that is writing the insurance policy. A group supervisory system in the U.S. (and around the world) is strongest if it keeps the liabilities and assets of the legal entities in focus.
>
> **Use of Statutory Accounting** – Due to the legal entity foundation of the U.S. system, the regulatory accounting system in the U.S. – which is referred to as Statutory Accounting – focuses on the entities that underwrite insurance and enter into insurance policies/contracts with policyholders, rather than a top-down consolidated accounting/valuation system like the one being contemplated for the current version of the ICS. Any international capital standard that would require U.S. companies to convert to a new accounting standard and would ignore the importance of legal entity regulation would be unreasonable for U.S. insurance groups, creating an unlevel playing field.
>
> **Aggregation Approach to Group Capital** – Due to the legal entity supervisory focus in the U.S., and the value of maintaining a view into the risk of each legal entity, U.S. regulators are properly focused on adding up or "aggregating" legal entity capital requirements in an accurate and risk-sensitive manner to reach acceptable consolidation of the group. Using a top-down consolidated approach as is required in the ICS could obfuscate valuable information about potential problems of individual legal entities. The design of the U.S. system and the need to continue the legal entity focus *requires* an aggregation system for group capital consolidation in the U.S. That is the only system that can work without basic foundational changes that will shake the entire structure of the U.S. insurance industry. This level of change in the U.S. is untenable.
>
> **U.S. Rating Structures and Regulation** – Some form of insurance rate regulation exists in all U.S. jurisdictions for property/casualty insurers. These rating laws follow the

standard that rates cannot be excessive, inadequate, or unfairly discriminatory. The legal rate standards have been interpreted to require that all rate structures are actuarially justified, and that each legal entity can only have one rate structure per insurance product. If property/casualty insurance groups want to experiment with a new rate structure, they can only do so through a different insurance legal entity.

In other countries there is flexibility within a single legal entity to set up business units with different rate structures for property/casualty insurers. Companies in those countries are also often able to charge whatever the market will bear, as the regulatory rate review is primarily focused on solvency. So, foreign companies can more readily increase their prices if more surplus/capital is needed. U.S. companies are not able to raise rates quickly just to increase their capital level, and any increase must be actuarially justified. This restricts U.S. insurance companies' ability to increase the level of capital they hold in the short run. This difference in the rating laws in the U.S., and the consequent difficulties in adding capital, contribute further to an unlevel playing field for U.S. insurance groups if an inflexible insurance capital standard is used in countries without similar regulation of insurance rates.

Hands-on Regulation – To keep this system functioning effectively the U.S. insurance supervisory system requires significantly more hands-on regulation than other countries as state supervisors are responsible for both solvency and market regulation. As noted above, many of the features of the U.S. system result in higher levels of solvency, a stronger more competitive system, and earlier identification of hazardous conditions that are not features of all regulatory systems.

Guaranty Funds – The U.S. regulatory framework is constantly evolving and reassessing risks, but ultimately, the system is not designed to completely prevent failure. Some companies must fail, or resources will be inappropriately distributed, and policyholders will suffer. Instead the U.S. system protects policyholders with insurance guaranty funds in all states, a feature not present in other regulatory regimes.

Despite making these arguments consistently over the last several years, the current version of the ICS is based on an artificially constructed consolidated group capital approach that is untethered to economic or legal realities, as well as highly controversial MAV accounting principles that lack any consensus on their validity for effectively supervising insurance groups. If some version of the current ICS were to be implemented as a formal standard:

- The U.S. insurance marketplace would be disadvantaged because of rate regulation and the impact on property/casualty insurers' ability to raise capital.
- U.S. consumers would be disadvantaged because of the IAIS insistence on an artificial, top-down consolidated group capital requirement, ignoring the U.S. capital system that

is based on a more granular legal-entity approach where an aggregated standard provides a more effective and efficient consolidated approach.

- The U.S. industry would be disadvantaged if new and inconsistent group capital and group supervision requirements arise out of the IAIS adding to the already significant solvency supervisory system at the state level.

IAIS To Move Forward With ICS in November

In recent negotiations, Team USA has sought to achieve mutual recognition of different regulatory approaches and flexibility in the ICS to focus more on the outcomes of insurance supervision. Ostensibly to that end, they claimed victory in 2017 with an IAIS Executive Committee agreement known as "the Kuala Lampur Agreement." It was decided that there must be a comparison of an approach that aggregates legal entities' capital requirements to achieve consolidation instead of requiring all jurisdictions to provide a top-down consolidated system of group capital that is used in the current version of the insurance capital standard before a final decision is made on the global standard. In other words, the IAIS has only agreed to *consider* the NAIC's work on an aggregated approach to consolidated group capital, the Group Capital Calculation (GCC) and the Federal Reserve's work on an Aggregation and Calibration Capital Requirement (BBA) over the next five years, known as the "monitoring period." And the other members of the IAIS claim that no further certainty or clarity about the acceptability of an aggregated approach for purposes of complying with the ICS is possible at this juncture, given that neither the GCC nor the BBA has finished field-testing or been finalized. This is nothing more than a red herring.

The finalization of the GCC and BBA aside, there is no reason – none – that the U.S. should be acquiescing to the establishment of a reference ICS that is based on MAV accounting and a top-down consolidated approach. After all, the reference ICS is what will be used to ultimately assess the GCC and the BBA. If the claim is that the U.S. cannot get the concessions it needs because the work is not yet done on its aggregated approaches to consolidation, the answer is not to move forward with a flawed metric in the meantime. At the very least, a halt should be called to the IAIS process while the work is being done, and the IAIS should be doing the difficult work of defining how to determine the comparability of the outcomes of different regulatory approaches, which will need to be done regardless.

Members of Team USA need to draw a line in the sand in November and not vote to move forward with the current reference ICS.

Conclusion – Acceptable Outcome Unlikely

All the U.S. has been asking for at the IAIS is flexibility and respect for different regulatory approaches, not a requirement that other countries use the exact same approach as the U.S. The U.S. needs are reasonable and yet they have not been fairly evaluated by the IAIS – while we have made these arguments consistently through the years, the IAIS is poised to move ahead in November with an ICS based on a top-down consolidated approach and MAV accounting principles. And the negotiating position of European stakeholders is unlikely to be one that will lead to an acceptable outcome.

Despite the many similarities that already exist between the current ICS and Solvency II, in the last month the trade associations representing the insurance companies in the EU, sent a letter to their insurance regulatory agency, seeking additional changes. The European trades state that the IAIS must ensure that Solvency II compliance will be adequate for ICS implementation and that companies in the EU must be allowed to use their internal capital models to determine each company's individual capital requirements instead of being required to use the standard formula in the ICS. Notwithstanding all of this demanded flexibility for European companies, the EU trades also insist that the IAIS effectively require all non-European insurance groups subject to the ICS to comply with the ICS standard formula including the adoption of the Solvency II-based top-down consolidated, market-adjusted valuation (MAV) capital system during the monitoring period. The letter implies that if their supervisors cannot persuade the IAIS to adopt these parameters that the European trades will not support adoption of the ICS in the EU.

This letter clearly illustrates the improbability of reaching consensus on any global capital requirement that respects jurisdictional differences and accommodates U.S. solvency regulation and capital requirements. If the IAIS does not make the appropriate policy accommodations of flexibility and acceptance of an aggregated approach to consolidation, members of Team USA should be prepared to vote against moving forward with the ICS into the monitoring period at the November meeting. Further, failure to achieve accommodation should call into question the entire IAIS workstream to create a global ICS for insurance groups, as it will demonstrate the competing positions are intractable and any resultant ICS cannot ultimately be adopted in the U.S.

Statement of the U.S. Chamber of Commerce

ON: Developments in Global Insurance Regulatory and Supervisory Forums

TO: United States Senate Committee on Banking, Housing, and Urban Affairs

BY: Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

DATE: September 12, 2019

The U.S. Chamber of Commerce's ("the Chamber") Center for Capital Markets Competitiveness appreciates the opportunity to offer a statement for the record for this hearing.

A key aspect of efficiency of the financial system is ensuring transparency and accountability for standard setting as it relates to the insurance sector. As the Senate Committee on Banking, Housing, and Urban Affairs holds a hearing entitled, "Developments in Global Insurance Regulatory and Supervisory Forums," the Chamber would like to share its view regarding the effects of insurance capital standards on the capital markets.

In recent years, standard-setting bodies have worked to develop standards that ensure cross-border solvency and stability for insurers with operations across regulatory regimes. In particular, the Insurance Capital Standard (ICS) currently under development by the International Association of Insurance Supervisors (IAIS) is an effort to define comparable standards and determine solvency levels for internationally active insurance groups (IAIGs). The development, and eventual implementation, of an insurance capital standard could broadly effect our capital markets.

This week, the Chamber finalized a new report on the aggregation method under development for measuring capital across an insurance group. This report follows a report the Chamber released in March 2019 that describes how the insurance industry invests in the U.S. economy.

The Chamber's September 2019 report[1] discusses one of the chief proposed methods of estimating insurance group capital, the aggregation method (AM). The National Association of Insurance Commissioners and Federal Reserve Board are developing the aggregation method, which is embodied in their Group Capital Calculation and Building Blocks Approach, respectively. The report considers the similarities and differences between the AM and other approaches to group capital,

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[1] U.S. Chamber of Commerce. Insurance Capital Standards and the Aggregation Method (Summer 2019), available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2019/09/CCMC_InsurancePaper2_v4-DIGITAL.pdf

such as the ICS, and the potential implications on insurers' business models and social impact across the many disparate markets within which these firms operate.

The Chamber's March 2019 report[2] finds U.S. insurance companies finance long-term improvements in the U.S. real economy that drive much-needed municipal infrastructure investments; support developers as they improve and construct commercial and multifamily properties; help farmers purchase needed land, buildings, and equipment; and fund a wide variety of business activity. The report finds that U.S. insurance assets totaled approximately $5.8 trillion as of December 2017. In addition, U.S. insurers have an outsize share of asset classes like corporate bonds (21 percent) and municipal bonds (20 percent). The industry's investments in education projects through municipal bond purchases could build about 1,000 elementary schools every year. Likewise, its annual investments in municipal bonds for transportation projects could build a road from Washington, D.C., to Los Angeles every year. This type of investment could be curtailed by the adoption of a new capital standard, especially one that is disruptive to existing regulatory requirements.

The development and implementation of an international insurance capital standard could have broad implications for our capital markets. These effects would be realized by policyholders, insurance firms, and the markets in which they invest.

[2] U.S. Chamber of Commerce. The Role of Insurance Investments in the U.S. Economy (Winter 2019), available at https://www.uschamber.com/press-release/us-chamber-releases-report-the-role-of-insurance-investments-the-us-economy

American Property Casualty Insurance Association
INSURING AMERICA apci.org

DAVID A. SAMPSON
PRESIDENT & CHIEF EXECUTIVE OFFICER

September 10, 2019

The Honorable Michael D. Crapo
United States Senate
239 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo,

The American Property Casualty Insurance Association (APCIA) is submitting the attached Statement for the Record for the Committee on Banking, Housing and Urban Affairs hearing entitled "Developments in Global Insurance Regulatory and Supervisory Forums" on September 12, 2019. APCIA appreciates this opportunity to comment on the latest version of the Insurance Capital Standard (ICS), which is a proposed global capital standard developed by the International Association of Insurance Supervisors (IAIS). APCIA is the primary national trade association for home, auto, and business insurers, and promotes and protects the viability of private competition for the benefit of consumers and insurers.

- The IAIS intends to adopt the ICS—over the opposition of all US representatives—this November. The ICS is not fit for purpose, and it is contrary to the time-tested state-based insurance regulatory system in the US. If widely implemented, the ICS could lead to competitive imbalances and discrimination against US insurers operating internationally, and it would be unworkable in the United States.

- US insurance regulators are developing aggregation-based group capital assessments that promise to be a far better fit for the US market and regulatory regime. However, the IAIS has resisted recognizing the aggregation-based US approach. The IAIS must adopt a clear and viable process for accepting the evolving US aggregation methodology, and the process must be based on objective and independent standards in order to ensure a level playing field for US companies.

- This Committee's hearing comes at exactly the right time. A successful resolution at the IAIS can only occur if US regulators coordinate, work effectively together, and, with strong Congressional support, commit to making IAIS recognition of the US approach a priority for the benefit of our consumers, companies, and markets. Congress should do all it can at this watershed moment to assist US regulators in their efforts to convince the IAIS to implement a clear path forward to recognizing the US aggregation methodology.

We hope that our Statement will be helpful as you prepare for the September 12th hearing. Please do not hesitate to contact us with any questions and thank you for your consideration.

Sincerely,

David A. Sampson

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American Property Casualty Insurance Association
INSURING AMERICA apci.org

STATEMENT BY DAVID A. SAMPSON, PRESIDENT AND CEO, FOR SEPTEMBER 12, 2019 HEARING OF SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

The American Property Casualty Insurance Association (APCIA) thanks the Committee for holding this very timely and important hearing on "Developments in Global Insurance Regulatory and Supervisory Forums." APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions – protecting families, communities, and businesses in the U.S. and across the globe.

APCIA is deeply concerned that the International Association of Insurance Supervisors (IAIS) will adopt an international capital standard that is unfit for purpose and potentially harmful to U.S, insurance groups, despite continued objections by U.S. state insurance regulators as represented by the National Association of Insurance Commissioners (NAIC), the Federal Reserve Board (FRB), and the Federal Insurance Office (FIO) of the U.S. Department of Treasury (collectively, "Team USA"). Guarding against this threat is precisely the purpose of the Heller-Tester International Insurance Capital Standards Accountability Act that Congress enacted last year. APCIA asks for continued strong Congressional involvement and support for our Team USA representatives as they engage with their international counterparts and urge a broader perspective that includes valid and robust alternative approaches to capital assessment.

The U.S. has the largest and most diverse insurance market in the world, with a 150-year track record of comprehensive state solvency regulation protecting consumers. The U.S. property casualty industry has played a major role in helping to bring about safer homes, workplaces, and highways through efforts that have saved countless lives and preserved important resources. Over the last three years, United States consumers suffered record losses from historic natural disasters – hurricanes, wildfires, earthquakes, and tornadoes. The insurance industry rose to the challenge, communicating closely with policyholders, working with federal and state disaster crews and regulators, and speeding claims payments to families and businesses suffering losses. Despite these tremendous challenges, U.S. industry solvency and financial strength have remained at record highs.

Although the capital standards of the U.S. insurance regulatory system have served the U.S. well, the IAIS continues to push for global approval of its proposed Insurance Capital Standard (ICS), which is not yet fit for purpose and is inconsistent with the U.S. insurance regulatory system. The IAIS currently intends at its November 2019 meeting in Abu Dhabi to force approval of its latest version of the ICS for a final monitoring period and subsequent implementation. U.S. regulators – the FRB and the individual state insurance regulators – have unequivocally stated that the ICS, as currently proposed, will not be adopted as part of the U.S. insurance regulatory system. Without significant revisions, however, the proposed ICS could potentially create competitive imbalances and discriminate against U.S. insurers if widely implemented in other jurisdictions.

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The ICS is currently "unfit for purpose."

The current version of the ICS is "unfit for purpose" for many reasons, including the following:

- the approach does not identify where capital weaknesses and available capital exist within a group (by entity or jurisdiction);
- there is no recognition of the restraints or costs related to moving capital within a group;
- regulators would need authority that extends beyond their home jurisdictions to apply the ICS, *i.e.*, the requirement is extra-territorial; and
- the valuations used in the standards under the market-adjusted valuation (MAV) approach are unaudited.

There are inherent difficulties in trying to draft a single global insurance capital standard. Perhaps the most pervasive of these problems involves differences in the needs and demand for private-sector insurance products and services across jurisdictions. Such needs are founded in differences in core jurisdictional-specific aspects such as legal structures, and national policies involving taxation, catastrophe recovery, policyholder protection systems, private vs. public sector funding and involvement, and a myriad of other issues that make it impossible for one global capital system to appropriately capture these inter-jurisdictional differences in a consolidated approach.

Rather than attempting to develop a system that builds upon and complements current, well-established regulatory systems, the IAIS decided to develop a one-size-fits-all global group standard modeled after the nascent European banking-style Solvency II regulatory system. As a result, the ICS produces a single group ratio that does not provide sufficient information on how group-wide risks impact the legal entity insurers within the group.

The ICS is intended to be a group indicator of capital adequacy, applicable to Internationally Active Insurance Groups (IAIGs). The ICS will be part of another IAIS supervisory product, referred to as the "Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame)." As the ICS has evolved from the ComFrame context in which it was created, it has become heavily skewed towards the banking/Solvency II approach. Indeed, the ICS imposes group capital requirements that are fundamentally inconsistent with the more extensive group supervision approach adopted by the United States and other jurisdictions.

Additional challenges in establishing a global capital standard arise due to jurisdictional differences in accounting and valuation standards. U.S. statutory accounting principles (SAP) and generally accepted accounting principles (GAAP) require valuation of property-casualty claim and expense liabilities at management's best estimate of their undiscounted ultimate cost, which is subject to an independent audit and can be back-tested. The current ICS proposal bases insurance liabilities on market-adjusted valuation (MAV), discounting insurance liabilities to present value and then adding a risk margin for the uncertainty in the expected liability – measures which preclude back-testing and therefore diminish reliability.

Under the MAV-based ICS proposal, short-term movements in market value create artificial and excessive volatility in capital requirements, even though the amount and timing of policyholder benefit and claim payments are unaffected by such market movements. The ICS proposal incorrectly assumes that the insurance group's capital, which may be domiciled in different states or countries, is fungible within the group, even in times of stress and across jurisdictions, without acknowledging the costs (including impact on policyholder protection) associated with moving that capital. In addition, the ICS does not recognize all material sources of capital typically available to U.S.-based insurance groups.

Lastly, the ICS proposal would be an inefficient approach to providing a global capital standard as it would require a global body to maintain the relevancy of risk factors for the products written throughout all the jurisdictions of the world even as new products arise and risks evolve in various regions/countries. In contrast, an aggregation approach leverages the work of local regulators to keep their capital standards relevant. The incentive and closeness to local risks makes local regulators more qualified for the task of keeping capital standards appropriate to their respective jurisdictions than a centralized global body.

Thus, APCIA is concerned that the combined impact of the above-mentioned adverse capital consequences of the MAV-based ICS proposal could negatively impact the availability and affordability of long-term insurance and retirement security products, as well as certain other property-casualty products, while also imposing significant implementation and ongoing maintenance costs on regulators and the U.S. industry. In brief, implementation of the ICS into the U.S. state-based regulatory system creates the potential to do more harm than good for the protection of U.S. policyholders.

Team USA and U.S. stakeholders strongly oppose the ICS.

Leadership at each of the Team USA constituent bodies have objected to the application of the ICS to the U.S. insurance marketplace. In addition, U.S. Treasury Secretary Steven Mnuchin stated at the May 2019 NAIC International Forum that if "these standards are adopted by foreign jurisdictions, they could have significant implications for U.S. insurers operating overseas, and potentially for our domestic insurance sector and regulatory regime" (https://home.treasury.gov/news/press-releases/sm688). Secretary Mnuchin criticized 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." Mnuchin suggested that, instead of racing to meet a "fixed schedule that mandates completion of the ICS at a specific point in time," the IAIS should "recognize and accommodate the diverse approaches to solvency regulation taken by various jurisdictions around the world, including our U.S. state-based regulatory system", and specifically recognize the U.S. aggregation approach to group capital as "outcome equivalent" to the ICS.

In January, FRB Vice Chairman for Supervision Randal Quarles stated that, "the ICS would face implementation challenges in the United States. For instance, such a framework may fail to adequately account for U.S. accounting frameworks, both Generally Accepted Accounting Principles (GAAP) and the NAIC's Statutory Accounting Principles, introduce excessive volatility, and involve excessive reliance on supervised firms' internal models." (https://www.federalreserve.gov/newsevents/speech/quarles20190109a.htm) Vice Chairman Quarles further stated that a "capital standard that uses market-based valuation can introduce volatility and procyclicality, and one that is excessively volatile or procyclical can influence a firm to veer away from a long-term perspective and concentrate instead on the short term. This can have undesirable consequences, including diminishing product availability."

At the May 2019 NAIC International Forum, the President of the NAIC, Maine Superintendent of Insurance Eric Cioppa, stated that the ICS "car is still missing two wheels." Cioppa specified that:

- The ICS is currently not fit for purpose; with many believing that no number of technical tweaks can address the fatal design flaws within the ICS.
- Alternatives to the ICS need to be recognized, such as an aggregation method.
- As currently designed, the ICS will negatively impact the ability of insurers to offer long-term products and make long-term investments.
- The idea of the ICS providing a "level playing field" is unrealistic and unnecessary for assessing an [internationally active insurance group's] group capital position, nor is it reflective of the strength of any particular supervisory approach.
- The assessment of comparable outcomes needs to focus on qualitative elements and the overarching objective, not simply a quantitative exercise that compares one number to another. (https://www.naic.org/documents/190513_speech_2019_forum_cioppa.htm)

U.S. insurance supervisors are building a better approach that should be equally recognized.

The states and the FRB are developing aggregation-based group capital assessment systems that promise to be a better fit for the U.S. market and regulatory system than the ICS in addition to being much more susceptible to ongoing maintenance and continued relevancy. Both the states and the FRB are building upon the current U.S. legal entity solvency regulation regime and accounting systems to develop this approach. The aggregation methodology leverages the existing legal-entity regulatory approach in the U.S. to allow both a legal entity/jurisdictional view, as well as a combined view, of an insurance group's capital.

The NAIC's Group Capital Calculation initiative (GCC) and the FRB's parallel Building Block Approach (BBA) are both based upon aggregation of current insurance *company* capital resources and capital requirements, using the long-established state risk-based capital (RBC) system and, where applicable, corresponding existing requirements for non-U.S. subsidiaries of a U.S.-based insurance group. These approaches would require significantly reduced transition costs since they are based on current accounting and capital requirements. Because the GCC and BBA require aggregation of legal entity information (rather than the ICS' consolidated, top-down approach), they will be more transparent in that regulators will know both the location and availability of capital *within* legal entities of the group (which is not a feature of the ICS). The aggregation methodology uses audited data (which the ICS does not), can be applied by any home jurisdiction (and a number of other jurisdictions are interested in using an aggregation method), and provides a pragmatic incremental way forward for the U.S. to achieve the IAIS' stated goals for the ICS without compromising the current accounting and regulatory framework. The aggregation methodology also addresses the issue of capital fungibility, which is a fatal flaw in the ICS approach.

Team USA should continue to advocate for recognition of the U.S. aggregation approach as outcome-equivalent to the ICS.

APCIA and the vast majority of the U.S. insurance marketplace share the concerns of our U.S. state and federal Team USA insurance leaders. To avoid these adverse consequences, recognition and acceptance by the IAIS of the evolving U.S. domestic aggregation-based approach to group capital assessment is essential. As noted, an aggregation methodology leverages the existing regulatory system to provide solvency information from the perspective of the entity, the group, and jurisdiction. Before acting on the ICS proposal, APCIA strongly supports efforts by Team USA to negotiate for IAIS agreement on:

- a plausible way forward for acceptance by the IAIS of an aggregation methodology, and
- an explicit commitment to developing a framework by which all capital assessment methodologies can be evaluated for comparable outcomes.

Achieving these commitments will require highly coordinated and assertive leadership by Team USA, which must speak with a unified voice. Strong Congressional support and oversight of these efforts will be critical to the United States' success at this stage in the IAIS' deliberations. APCIA greatly appreciates the Committee's ongoing and bipartisan oversight to ensure that a strategic and coordinated effort remains a high priority for Team USA.

Timing – the IAIS is seeking to lock-in the ICS at its November 2019 Meeting.

At its Annual Conference in mid-November, the IAIS will vote to approve the current MAV-based ICS for a five-year monitoring period before implementation. During that monitoring period, pursuant to terms of the "Kuala Lumpur Agreement" agreed to by IAIS members in 2017 (KL Agreement), IAIS members will be expected to require the 50 or so IAIGs to annually report group capital on an ICS basis to their group-wide supervisors and members of their supervisory colleges. After the monitoring period and adoption of the final version of the ICS, member jurisdictions, including the United States, will be expected to implement the ICS in their home jurisdictions. However, the FRB and the NAIC have already stated that U.S. insurance regulators will not adopt and implement a MAV-based ICS in the U.S.

The KL Agreement also provides for continued consideration of other variations of the ICS:

- GAAP Plus: utilizes local country accounting rules, with certain defined adjustments;
- Internal Models (IM): uses company-specific capital models; and
- Aggregation: adds together the entity capital requirements and capital resources within group; the KL Agreement provides that this approach will be evaluated by the IAIS on the basis of producing comparable outcomes to the MAV-based ICS.

The global insurance industry, Team USA, and several other country regulators recognize that the ICS is severely flawed and will certainly not be fit for purpose by November 2019, even for those jurisdictions that plan to adopt a MAV-based ICS. The IAIS has accepted the possibility that changes may be necessary during the monitoring period, and that a separate IAIS vote will be held on the revised ICS before it is expected to be implemented. In the meantime, however, IAIGs that will report on an ICS basis strongly believe that those results must be kept confidential, since they would likely not be an accurate reflection of the company's solvency position and would be inherently misleading.

Some banks, rating agencies and other third parties have already begun asking IAIGs for their ICS results. APCIA's concern is that competitive pressures on those groups may force disclosure of ICS information. Part of the problem rests with the labelling of the "monitoring period" – even the IAIS now admits that the only thing worthy of "monitoring" is how the ICS and its revisions perform over an extended period.

The November 2019 IAIS meeting will also be a critical watershed moment for whether Team USA can achieve IAIS agreement on a process for determining whether the U.S. aggregation method is sufficiently comparable to the ICS so as to be an outcomes-equivalent means to implement the ICS. The IAIS has not arrived at any criteria for determining comparability and does not plan to do so until some undefined point in time during the 5-year monitoring period. Team USA has indicated that most other IAIS members with whom they are engaged in ICS negotiations hold the view that comparability is simply a matter of comparing the resulting numeric ratios of ICS and aggregation; *in other words, any other method must produce a numerical ratio nearly identical to the ICS or else be considered to fail the comparability test*. This view of outcome comparability essentially assumes that the ICS itself – as a metric - is the perfect benchmark for determining comparability. Instead of demanding strict adherence to an unproven and flawed ICS approach as a measure of comparability, Team USA and the U.S. industry are asking the IAIS to (1) develop an independent way by which all methods are compared (including the MAV-based ICS) to unbiased and objective benchmarks, that (2) uses both quantitative and qualitative methods, that (3) defines "outcome" as the point in time corrective supervisory intervention is triggered by each system, and that (4) makes a comparison on that basis.

What Team USA should seek instead

- Team USA should insist that, before moving forward with adoption of the MAV-based ICS , the IAIS adopt a clear process for creating a comparability framework, based upon independent standards, by which aggregation, the MAV-based ICS, internal models, GAAP Plus, and other jurisdictional group capital assessment methods can be evaluated by the IAIS as achieving comparable outcomes in policyholder protection. The U.S. cannot – and state regulators have indicated that they will not – adopt and implement an ICS that is based upon market-adjusted valuation, as it is inconsistent with the U.S. regulatory system. Put simply, the ICS cannot be considered a global capital standard if the world's largest market – the United States – is not included. There must be clear, unbiased means for both the aggregation method and the MAV-based ICS to be assessed against impartial standards in determining whether the aggregation method may trigger supervisory action *at a similar point* as the ICS.

- Team USA should insist that the IAIS clarify: (1) that the ICS is not fit for **any** purpose during the period 2020-2024, other than to test how it behaves over a period of years, and that the ICS will be subject to significant revisions as necessary with appropriate consultation with stakeholders; (2) that the IAIS will seek consensus that a revised ICS is fit for purpose **before** requesting its adoption and ultimate implementation by member jurisdictions; and (3) that individual company ICS results should be kept strictly confidential during the monitoring period. These commitments are essential to ensure that IAIGs are not harmed during the period by a standard that does not provide an accurate picture of capital adequacy. The IAIS should also consider using a different label than "monitoring period", one that cannot be read to imply that ICS is useful to third parties for any purpose.

- U.S. insurance groups should not be required to report on an ICS basis during that period but can do so voluntarily. Since U.S. regulators have made it clear that the MAV-based ICS will not be required in the U.S. and that an aggregation method will be implemented instead, it would be costly and senseless to require U.S. IAIGs to also provide a MAV-based ICS report. That said, we understand that eight U.S.-based groups are participating in IAIS field testing on a voluntary basis, and nothing should prevent them from continuing with the monitoring period reporting should they so choose.

- Team USA needs to be committed to constructive engagement now and in the long-term and empowered and encouraged to apply the full authority of the United State to insist on a favorable resolution of these issues. Team USA should stand firmly united against moving forward with the ICS 2.0 if there is not an appropriate part to that outcome.

- **U.S. success at the IAIS in November will require a complete commitment and high-level leadership by Team USA, strong support and urging from Congress, and full cooperation from the U.S industry**

APCIA appreciates the efforts of all the members of Team USA to represent U.S. interests at the IAIS and to maintain a unified commitment to an ICS that reflects the U.S. state-based regulatory system, and we have worked hard to encourage continually increased cooperation among them. It is critical now more than ever that Team USA unite behind a strong U.S. position and advocate it vigorously at the IAIS, using all the appropriate resources, political capital, and leadership at this pivotal watershed moment -- not only at the November IAIS committee meetings and Annual General Meeting in Abu Dhabi, but during the preceding meetings of key IAIS working groups and its Executive Committee during September and October. This Committee's hearing comes at exactly the right time to promote and reinforce this unity, political will, and commitment.

Team USA should also be encouraged not to make concessions to other parties within the IAIS without receiving an appropriate quid pro quo in return. It is essential that, at the time when key decisions are made, both the U.S. and European sides have something important at stake. One-sided negotiations have not worked well during this process. In particular, adoption of internal models as part of the ICS must be accompanied by acceptance of the aggregation method as an outcomes-equivalent basis for implementation of the ICS in the U.S.

Conclusion

The IAIS is trying to move forward with proposed global group capital standards that have been criticized as unfit for purpose by the U.S. state insurance regulators, Treasury, the FRB, and much of the global insurance industry. APCIA hopes that Congress will make it a priority to ensure that Team USA remains united and committed to working closely together, domestically and internationally, with the support of the marketplace, to demand a better deal -- one that will work for the U.S. marketplace and recognize and accept the U.S. system. We thank the Committee for underscoring the importance of this effort.

Statement for the Record

Submitted to the

U.S. Senate Committee on Banking, Housing, and Urban Affairs

"Developments in Global Insurance Regulatory and Supervisory Forums"

September 12, 2019

The American Council of Life Insurers (ACLI) thanks Chairman Mike Crapo and Ranking Member Sherrod Brown for holding this important hearing on the "Developments in Global Insurance Regulatory and Supervisory Forums." Included in this submission is the letter ACLI President and CEO, Susan Neely has sent to Team U.S.A. regarding the proposed International Capital Standard (ICS) being developed by the International Association of Insurance Supervisors (IAIS).

ACLI strongly supports our state-based system of insurance regulation and believes that only through a united front among "Team USA" members at the IAIS can we demonstrate that our system has been and will continue to be a success. ACLI stands ready to assist Team U.S.A. and Members of Congress to ensure that the interests of the U.S. life insurance industry are ably represented in this and all international regulatory negotiations.

ACLI is the leading trade association driving public policy and advocacy on behalf of the life insurance industry and the 90 million American families relying on life insurers' products for financial protection and retirement security. ACLI's 280 member companies represent 95 percent of industry assets and are dedicated to promoting consumers' financial well-being with products that reduce risk and increase their financial security, including life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision insurance and other supplemental benefits. The core business of the life insurance industry is financial security, and retirement security is a critical mission. As society and work change, the industry is committed to solutions that protect all Americans, regardless of where and how they work, their life stage, or the economic status of their household. Life insurers seek to expand the availability, accessibility, and affordability of financial protection and retirement security products for all.

ACLI respectively requests this letter is submitted to the hearing record.

ACLI Financial Security...for Life. | American Council of Life Insurers

Susan K. Neely
President & Chief Executive Officer

September 5, 2019

Mr. Michael Consedine
Chief Executive Officer
National Association of Insurance Commissioners

Mr. Steven Seitz
Director, Federal Insurance Office
U.S. Department of the Treasury

Mr. Thomas R. Sullivan
Associate Director
U.S. Federal Reserve Board

I'm writing on behalf of the American Council of Life Insurers (ACLI)[1] to reiterate our strong support for: a unified "Team USA," our state-based system of insurance regulation, and your continued coordinated efforts at the International Association of Insurance Supervisors (IAIS) to improve the emerging Insurance Capital Standard (ICS). This includes recognition of alternative group capital methodologies, such as the U.S. Aggregation Method.

In advance of the November IAIS annual meeting in Abu Dhabi, I am also sharing concerns about the ICS with the hope that they will be addressed ahead of, and during, the annual meeting.

The IAIS is committed to adopting ICS Version 2.0 and moving forward with the five-year Monitoring Period (2020-2024). Our industry has strong concerns that the ICS is not yet fit for purpose and will require significant further work that will not be completed by November of 2019. In its current form, the ICS is also not suited for the needs of all markets including the United States. Accordingly, we strongly support recent IAIS public commitments to another public consultation on the ICS during the Monitoring Period, with an aim to further improving the pending standard. In that light we make the following requests:

1. *We urge Team USA to advocate for further key technical improvements to the ICS now and through the Monitoring Period.* In addition the IAIS should produce a formal statement, issued with the adoption of ICS Version 2.0 in November, publicly reconfirming that there will be further public consultation during the Monitoring Period. To leverage key findings from the 2019 ICS Field Test before Version 2.0 is adopted, we urge Team USA to push IAIS to make necessary technical improvements to the ICS that more appropriately reflect long duration insurance business. Please let us know how we can be helpful in identifying the specific critical changes.

2. *We urge Team USA to push the IAIS to explicitly confirm its willingness to consider other approaches as outcome equivalent to the ICS MAV approach.* We are concerned that the IAIS has not provided any further detail

[1] The American Council of Life Insurers (ACLI) advocates on behalf of 280 member companies dedicated to providing products and services that promote consumers' financial and retirement security. 90 million American families depend on our members for life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, dental and vision and other supplemental benefits. ACLI represents member companies in state, federal and international forums for public policy that supports the industry marketplace and the families that rely on life insurers' products for peace of mind. ACLI members represent 95 percent of industry assets in the United States.

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beyond its 2017 statement, which stated that it will assess comparability of alternative methodologies by the end of the five-year Monitoring Period. It is our hope that the IAIS will state that the assessment of alternative aggregation approaches will be based upon achieving comparable outcomes expected of robust and resilient solvency regimes for internationally-active insurance groups, and not upon pure quantitative similarities that would be an inappropriate comparison of an aggregation framework to a consolidated framework.

The IAIS should also publish a work plan for completing the comparability criteria, including an appropriate time frame, clear process, and opportunities for stakeholder input. This added transparency into the assessment process will allow for more useful input and feedback and will help ensure that all interested parties have an opportunity to participate in the process.

In this regard, we strongly encourage Team USA to continue to advocate for principles and a work plan for assessing comparability to be developed and agreed to by the IAIS annual meeting in Abu Dhabi. We appreciate Team USA's continued efforts to build an adequate knowledge base and to promote participation in data gathering on the Aggregation Method to ensure that it is well understood and that sufficient data is available for IAIS review in assessing its comparability.

3. *We urge Team USA to support an IAIS public statement that would mitigate the risk to the industry that the ICS will be used inappropriately during the Monitoring Period.* The IAIS statement we envision would address the following: (1) Version 2.0 is not the final version and is not yet a meaningful analytical measure suitable for use by supervisors or third parties; (2) company results reported during the Monitoring Period need to be kept confidential and should not be shared with any external parties by supervisors and firms alike; and (3) supervisors and third parties must not rely upon any results generated during the Monitoring Period for any purpose, as they are meant only to serve as input to the IAIS on the performance and refinement of the ICS. *We also urge Team USA to issue a separate U.S. statement in Abu Dhabi along these lines for clarity for U.S. firms.*

4. *We urge Team USA to advocate for the IAIS to commit to a robust, iterative, and independent third-party economic impact analysis.* This analysis would help the IAIS and its members to ascertain and address the consequences of the ICS and its potential negative impacts across cycles on economic growth, financial stability, insurance markets, risk mitigation, investment strategies, and consumers. The IAIS should seek stakeholder input into the design of the analysis and it should be performed early enough in the Monitoring Period to allow for changes to be made to the ICS. It is important that the FSB have a direct line of sight to and involvement in this analysis.

Thank you for your continued leadership on these challenging and important issues. Please let me know what ACLI members can do to help your efforts to achieve these goals. We stand ready to assist you and request your continued engagement with industry stakeholders as you advocate on behalf of the United States.

Sincerely,

Susan K. Neely

Susan K. Neely
President and CEO

cc: David Altmeier
Gary Anderson
Dean L. Cameron
Eric A. Cioppa
Linda Duzick
Raymond G. Farmer
Elise Liebers
Andrew N. Mais
Bimal Patel
Ethan Sonnichsen
Andrew Stolfi
J. Tyler Williams

To: Valdis Dombrovskis
Vice-President, DG Financial Stability, Financial Services and Capital Markets Union
European Commission

Cc: Gabriel Bernardino
Chairman
EIOPA

Didier Millerot
Head, Insurance and Pensions Unit
European Commission

Our reference: ECO-19-076

Subject: European insurance industry views on the global Insurance Capital Standard

Brussels, 26 August 2019

Dear Vice-President Dombrovskis,

We are writing to you to share the European insurance industry's views on the current stage of development of the global Insurance Capital Standard (ICS).

The coming months are crucial ones in the efforts of IAIS members to reach agreement on key elements of ICS 2.0. The ICS project is of particular relevance to and impact for the European industry, given that more than half of the IAIGs that are in the scope of ComFrame/ICS are European groups and that the ICS has a direct impact on insurers' global competitiveness.

Ahead of the monitoring period, the European industry calls for a **global level playing field for all IAIGs and all participating jurisdictions to be ensured**. This means that all jurisdictions and IAIGs commit to the Kuala Lumpur (KL) Agreement, which includes:

- Confidential reporting, by all IAIGs, of the reference ICS 2.0, which is based on market-adjusted valuation (MAV).
- The existence of supervisory colleges for all IAIGs (in which ICS 2.0 would be discussed). These should have a similar composition and role and should be in place before the monitoring period starts.

The **monitoring period** is key to making progress towards a meaningful and consistent, global, single, group-wide ICS. The industry therefore believes that:

- The IAIS should publicly state and ensure that the monitoring period is for monitoring how well ICS 2.0 works as a standard and not for monitoring the solvency of individual IAIGs or for any level of use by third parties. As foreseen in the KL Agreement, the monitoring period should remain a **confidential** exercise between IAIGs and group-wide supervisors and the results should not be disclosed to external stakeholders and third parties.
- The **ICS framework should be stabilised** before adoption of ICS 2.0. Currently, key elements (eg valuation, capital calibrations, the margin over current estimate) are still under discussion. It is important that decisions on key aspects of the ICS are made before adoption of ICS 2.0 to confirm that convergence and agreement within the supervisory community is achievable.

- The monitoring period should **identify potential flaws in the ICS and fix them** as and where needed. The process should be similar to the Solvency II quantitative impact studies (QISs) conducted between 2005 and 2013. Europe is engaged in the Solvency II 2020 review, which will consider a range of improvements, in particular addressing flaws in the treatment of long-term business. The work done on the Solvency II 2020 review should inform the contributions by European NSAs and EIOPA to the ICS project.
- The monitoring period should **limit the reporting burden on companies**, which are already faced in Europe with extensive Solvency II requirements, biennial stress-testing exercises and data calls for the 2020 review, as well as the implementation of future changes that emerge from that review.

In addition, the European industry calls on EIOPA and European NSAs to focus the necessary attention on **internal models,** which are a key risk management and capital measurement tool and should be a permanent and integral part of the ICS framework in the same way as they are in Solvency II. Such internal models — intended solely for a more accurate calculation of the capital requirements at the same confidence level as the standard method and subject to a number of appropriate requirements — will enhance the ICS. European supervisors should take the opportunity of the monitoring period to highlight how internal models are necessary for the ICS to work in practice by ensuring the correct measurement of more complex risks and structures not addressed by the standard method.

In line with the KL Agreement, the second phase of the ICS will be its implementation as a group-wide PCR. The ultimate decision on whether the final ICS will be implemented in Europe lies, of course, with the European co-legislators. Solvency II is already based on a market-adjusted-valuation, which is a key element of the ICS. Should Europe decide to implement the standard, the industry expects, therefore, that the **post-2020 review version of Solvency II** (including internal models and other key elements such as transitionals and equivalence) will be Europe's **implementation of the ICS**.

It is difficult to be confident about future developments in the political and regulatory landscape. If the relationship between the ICS and Solvency II does not develop as we hope, then the European industry believes that **the ICS should be considered for implementation in Europe only if all major jurisdictions commit to implementing it consistently**. This is the only way to guarantee a global level playing field for the European industry.

A **single set of prudential rules within Europe**, covering group and solo levels, is key today and in the future. An outcome in which the industry would have to run business under two parallel and differing prudential regimes would be unworkable.

European stakeholders engaged in the ICS project should ensure that **the ICS does <u>not</u>**:
- create competitive disadvantages for Europe vis-à-vis other jurisdictions;
- endanger the availability and raise the cost of products that are highly valued by consumers;
- threaten the ability of insurers to continue to invest in long-term economic growth; or,
- create macroprudential and financial stability risks, including pro-cyclical investment behaviour.

We would be grateful if you would take the points above into consideration in your engagement with the IAIS.

Yours sincerely,

Andreas Brandstetter
President, Insurance Europe

Thomas Buberl
Chairman, Pan-European Insurance Forum

About Insurance Europe

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of more than €1 200bn, directly employ over 950 000 people and invest over €10 200bn in the economy.

About the Pan-European Insurance Forum (PEIF)

The PEIF is a forum for the CEOs of major European headquartered international (re)insurers (Aegon, Allianz, AVIVA, AXA, GENERALI, MAPFRE, Munich Re, RSA, Swiss Re, UNIQA, and Zurich) to exchange and present views on policy and regulatory issues impacting the European insurance sector. PEIF aims to promote a better understanding and recognition of the role of the insurance business model in the European Union and to provide its Members with the opportunity to discuss major policy and strategic issues affecting the insurance business in Europe and worldwide.

United States Senate
WASHINGTON, DC 20510

May 13, 2019

The Honorable Randal Quarles
Vice Chairman for Supervision
Board of Governors of the
Federal Reserve System
Constitution Ave. NW & 20th St. NW
Washington, DC 20551

Dear Vice Chairman Quarles:

We write to commend your January 2019 speech regarding insurance supervision and international engagement. In particular, we were pleased to hear that you are working with your foreign counterparts to establish an assurance that the United States regime of state-based insurance regulation is, in your words, "deemed comparable to the [International Capital Standard]" being developed by the International Association of Insurance Supervisors (IAIS). The Federal Reserve's clear understanding of the nuances of our state-based system and your commitment to the domestically-regulated insurance market, as well as your commitment to tailoring regulation to activities and risk and not to arbitrary thresholds, has helped keep our insurance system safe and strong.

Regarding work being done by the IAIS on the International Capital Standard (ICS), it is our view that the FSB should publicly state that a global capital standard for insurers is not required. We understand that the National Association of Insurance Commissioners (NAIC) is developing a group capital assessment tool and the Federal Reserve Board is developing a group capital standard based on an aggregated entities approach, and that the NAIC will begin field testing its approach this Spring. It is also our view that, in advance of the November 2019 IAIS Annual General Meeting, the FSB should publicly state that aggregation approaches to group capital as well as other well-developed and proven jurisdictional capital regimes are acceptable methodologies for assessing group capital adequacy.

We share the concerns you raised regarding the European Solvency II framework and the impact that a similar approach, if taken in the final ICS and applied to U.S.-based groups with operations abroad, could have on the U.S. economy and the ability of the insurance industry to provide critical insurance protection. As you pointed out in your speech earlier this year:

> "...much of ICS's evolution has been in the direction of a valuation method and overall framework that reflect approaches used elsewhere in the world. This may not be optimal for the United States insurance market."

We appreciate your attention to and focus on the need for insurance group capital standards to be "stable in its valuation, conservative in its design, and appropriately reflective of financial soundness." We hope you encourage this approach with your colleagues on the FSB.

We question the need for an ICS, but appreciate you pointing out that "The standards produced through the IAIS are, of course, not binding upon the United States." Our concern is that, even if those standards are nonbinding on the U.S., they may still present real and negative ramifications for U.S. insurers operating in markets abroad. For example, U.S. insurers operating abroad could face various non-tariff forms of regulatory retaliation which would harm U.S. consumers as well as global insurance markets given that the ICS as currently constructed discourages insurance products with long-term guarantees – products that are necessary for providing retirement security for aging populations.

In addition, regarding the proposed ICS, you state:

> "In order for any form of an ICS to be implementable globally, it needs to be suitable for the U.S. insurance market. The current core proposal in the ICS would face implementation challenges in the United States. For instance, such a framework may fail to adequately account for U.S. accounting frameworks, both Generally Accepted Accounting Principles (GAAP) and the NAIC's Statutory Accounting Principles, introduce excessive volatility, and involve excessive reliance on supervised firms' internal models."

We fully agree that an ICS that is not implementable in the United States – the world's largest insurance market – would fail to be a global standard. The IAIS should seek to avoid such an outcome by pursuing an ICS that recognizes aggregation approaches to group capital and other well-developed, proven insurance solvency regulatory systems.

Unfortunately, the IAIS has not committed to recognizing aggregation methods such as those being pursued by the Federal Reserve and the NAIC. Instead, it has agreed to determine whether such approaches are "outcome equivalent" by the end of the five-year monitoring period of the ICS in 2024.

In the meantime, U.S.-based insurers with operations abroad will face significant regulatory uncertainty. We ask that you, as Chair of the FSB, call on the IAIS to alleviate the regulatory uncertainty the ICS project has created at its November 2019 Annual General Meeting. It is our view that to adequately address the regulatory uncertainty the ICS has created, the FSB should urge the IAIS to issue a public statement in November that addresses the following points:

- The ICS is not intended to be a global mandate and that aggregation approaches to capital, such as those being developed by the NAIC and the Federal Reserve, as well as other well developed and proven capital regimes, are acceptable for purposes of the ICS. Additionally, the process for determining "outcome equivalence" of alternative methods and approaches to an ICS, will be expeditiously defined and will consider both qualitative and quantitative aspects of the approaches and supervisory frameworks.
- An expectation that alternative approaches can, and likely will, meet the FSB's goal of ensuring robust and resilient insurance regulatory regimes that take into account the important role that insurance plays in meeting the varying public policy goals of each jurisdiction to protect aging populations and the need for long-term, sustainable investments.
- It should be clearly stated that design and calibration changes will be made to the ICS throughout the Monitoring Period to address ongoing shortcomings of the framework and its predisposition to cause unintended consequences.
- The confidential nature of ICS results and data should be reinforced. Further, external stakeholders (e.g., investors, rating agencies, underwriters, etc.) should be made aware of the lack of value/meaning that should be assigned to ICS results given the developmental nature of the framework and non-binding nature of IAIS standards.
- The IAIS should acknowledge the primacy of jurisdictional group capital regimes and frameworks.

We commend your attention regarding, and command of, the important issues at hand and request that you share your view regarding plans and processes for achieving international recognition of the U.S. aggregation approaches to group capital and other well-developed, proven insurance solvency regulatory systems.

Thank you for your dedication to tackling these complicated and complex multilateral regulatory issues and for standing up for American interests abroad. International dialogue and cooperation among regulators is vital in allowing continued cross-border competition that respects the local jurisdiction's sovereignty and regulatory approach while also allowing consumers to benefit from more competition and choice. We encourage you to work closely with your colleagues to make certain that we reach an optimal outcome for American consumers, markets, and businesses.

Sincerely,

M. Michael Rounds	Tim Scott
United States Senator	United States Senator

Kyrsten Sinema
United States Senator

Patty Murray
United States Senator

Martha McSally
United States Senator

Tom Cotton
United States Senator

Jerry Moran
United States Senator

John Boozman
United States Senator

Susan M. Collins
United States Senator

Mike Crapo
United States Senator

Thom Tillis
United States Senator

Kevin Cramer
United States Senator

Shelley Moore Capito
United States Senator

Cindy Hyde-Smith
United States Senator

David Perdue
United States Senator

Joni K. Ernst
United States Senator

Jeanne Shaheen
United States Senator

Johnny Isakson
United States Senator

John Thune
United States Senator

John Barrasso
United States Senator

John Hoeven
United States Senator

Lisa Murkowski
United States Senator

John Kennedy
United States Senator

Pat Roberts
United States Senator

Margaret Wood Hassan
United States Senator

Marsha Blackburn
United States Senator

James M. Inhofe
United States Senator

Bill Cassidy
United States Senator

Ben Sasse
United States Senator

Debbie Stabenow
United States Senator

Gary C. Peters
United States Senator

Pat Toomey
United States Senator

Joe Manchin III
United States Senator

Roger F. Wicker
United States Senator

Deb Fischer
United States Senator

Mike Braun
United States Senator

Todd Young
United States Senator

Steve Daines
United States Senator

Tammy Baldwin
United States Senator

Angus S. King, Jr.
United States Senator

John Cornyn
United States Senator

Ron Johnson
United States Senator

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

RANDAL K. QUARLES
VICE CHAIRMAN FOR SUPERVISION

July 9, 2019

The Honorable M. Michael Rounds
United States Senate
Washington, D.C. 20510

Dear Senator:

Thank you for your letter dated May 13, 2019. The Financial Stability Board (FSB) is responsible for monitoring and assessing vulnerabilities affecting the global financial system, and proposing actions as necessary, to address them. As part of this role, the FSB works with the International Association of Insurance Supervisors (IAIS) in evaluating the feasibility of an implementable Insurance Capital Standard (ICS), a project the FSB began at the IAIS in 2013. As you know, the relationship between the FSB and the IAIS is not a heirarachical one: while the FSB has responsibility for the global overview and can have influence on actions of the individual international standard setters, the responsibility for setting international standards in insurance regulation rests with the IAIS. The IAIS members, including the U.S. members, colloquially referred to as "Team USA" — which include the Federal Reserve Board (Board), Federal Insurance Office and National Association of Insurance Commissioners (NAIC) — bring the relevant technical expertise to the work to identify and to address a range of unresolved policy issues. U.S. members of the IAIS are committed to supporting approaches that are appropriate for U.S. companies, operating domestically and internationally, through continued development of an implementable ICS, together with an aggregation method.

An international standard like the ICS, if implemented by individual jurisdictions, has the potential to limit regulatory arbitrage and help to provide a level playing field for internationally active insurance groups. It can also help ensure that foreign insurers operating within the United States are held to appropriate standards by their foreign group-wide supervisor, thereby limiting risk to their U.S. customers. To achieve those worthwhile goals, however, it must be a standard that is practical to implement in all the world's major jurisdictions. If the IAIS develops a standard that cannot be implemented in the United States, it could in fact encourage rather than limit arbitrage, and increase rather than decrease risk.

The Honorable M. Michael Rounds
Page Two

In 2017, the IAIS announced that it would release the ICS in two phases: a five-year monitoring period beginning in 2020, followed by implementation of a prescribed capital requirement, for those jurisdictions that formally adopt the ICS. The U.S. members of the IAIS as well as certain U.S. companies have concerns that the ICS, as it currently stands, includes a valuation method and other requirements that may not be optimal for the U.S. insurance market and may lead to unintended consequences. The valuation method of the current ICS may be prone to volatility, which can affect long-term contracts especially and impair the ability of insurers to provide long-term life insurance and retirement planning products.

Also in 2017, at the recommendation of the U.S. members, the IAIS committed to the data collection and analysis of an aggregation method, an alternative approach to determining capital resources and capital requirements for a group-wide capital standard. It is our expectation that the Federal Reserve's development of a Building Block Approach (BBA), together with the development of the Group Capital Calculation by the NAIC, will assist with U.S. advocacy of the aggregation method. Our goal is to have the aggregation method deemed equivalent to the ICS, and through Team USA's efforts, we have created space in the international dialogue for U.S. approaches to capital to be recognized as providing comparable outcomes.

Recognizing the concerns that many internationally active companies — both U.S. and non-U.S. — have with what is currently known about the ICS, and mindful of the appropriate relationship between the FSB and the IAIS, I have set up a joint meeting, including both the Chair of the IAIS Executive Committee, and me, as well as other senior members of the FSB and IAIS, in London next week with a number of internationally active companies to discuss these issues.

As evaluation of the feasibility of an ICS proceeds, it is important to recall that in order for any form of an ICS to be implementable, it needs to be suitable for the U.S. insurance market. Furthermore, the ICS, or any standard produced by the IAIS, is a voluntary standard that is not binding and would need to be adopted voluntarily by each member jurisdiction in accordance with applicable domestic laws.

I appreciate you sharing your thoughts and concerns on this matter and I hope you find this information helpful.

Sincerely,