International Association of Insurance Supervisors Stakeholders Meeting

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IAIS Proposal for Global Insurance Capital Standards

- ***Principal Objectives of IAIS Proposed Risk-based Global Insurance Capital Standard***
  - Promote protection of policyholders and contribute to global financial stability
  - Develop a globally comparable risk-based measure of capital adequacy for GSIIs and IAIGs
  - Develop a single framework to allow more effective monitoring of global insurance market
  - Strike appropriate balance between risk sensitivity, simplicity, and transparency

- ***Capital Requirements and Frameworks Exist for Largest Developed Global Insurance Markets***
  - United States – National Association of Insurance Commissioners (NAIC) Risk-based Capital
  - European Union – Solvency II
  - Asia – e.g., Japan FSA

- ***Effective Surveillance and Enforcement Mechanisms Present in Developed Markets***
  - With few exceptions, jurisdictional capital requirements have worked well
    - Monitoring and enforcement mechanisms in place and effective
    - Regulators have tools to effectively identify and address emerging issues in a timely manner
  - Local and national frameworks can be leveraged for effective global surveillance

- ***IAIS Developing a Framework to Monitor Global Insurance Market for Existing/Emerging Risks***
  - IAIS working diligently to create infrastructure to monitor global insurance market for existing/emerging risks
  - Currently pursuing a single global insurance capital standard (ICS)
  - Field-testing underway – challenges emerging due to jurisdictional uniqueness of insurance products
    - Product design and features customized to meet differing local needs and laws
  - U.S. has unique products to meet local customer needs and laws
    - U.S. supports a GAAP + Adjustments approach (as described in IAIS Proposal) to meet ICS objectives
    - ICSCA impacts valuation approaches for groups regulated by Fed (i.e., SIFIs and SLHCs)

IAIS – International Association of Insurance Supervisors	**GSII** – Global Systemically Important Insurers	**IAIG** – Internationally Active Insurance Group
SLHC– Savings & Loan Holding Companies	**ICSCA** – Insurance Capital Standards Clarification Act	**Fed** – Federal Reserve Board

U.S. Regulator Work on Capital and Solvency can Inform IAIS Work

– ***Principal Provisions of the Insurance Capital Standards Clarification Act***

- ICSCA provides that insurance entities that only prepare financial statements in accordance with Statutory Accounting Principles (SAP), a regulatory form of GAAP, may not be required to report on a U.S. GAAP basis
- ICSCA provides Fed discretion to recognize U.S. Risk-based Capital (RBC) framework for state regulated insurers (i.e., NAIC RBC) and qualifying foreign affiliates (e.g., Solvency II) if Fed judges those capital requirements to be adequate
- ICSCA elevates U.S. SAP to equivalence with U.S. GAAP for Fed group capital evaluation purposes

– ***Potential Impact of ICSCA on U.S. GAAP + Adjustments Proposal***

- Objective of U.S. GAAP + Adjustments Proposal
  - Leverage existing, relevant jurisdictional frameworks (e.g., NAIC RBC, Basel III, Solvency II, etc.) to meet objective of IAIS Group ICS
    - **Pre-ICSCA:** U.S. GAAP viewed as likely measurement framework for a U.S. group
    - **Post-ICSCA:** Fed must recognize U.S. SAP for state-regulated insurers that file financial statements only in accordance with SAP
  - "Adjustments" would promote comparability and facilitate IAIS evaluation
    - Adjustments limited to items from audited GAAP statements or a SAP requirement per SEC Reg G
- U.S. GAAP + Adjustments revised for ICSCA:
  - U.S. SAP designated as measurement framework for U.S. insurance operations
  - For U.S. insurance operations, NAIC RBC designated an adequate capital requirement (ACR)
  - For non-U.S. insurance operations utilize measures from consistently calibrated relevant capital frameworks (e.g., Solvency II) if deemed an ACR
  - For banking and securities activities utilize measures from consistently calibrated relevant capital frameworks (e.g., Basel III, FINRA, etc.)
  - For other non-insurance, non-banking activities apply a consistently calibrated capital factor to assets (e.g., 10%)
  - Required capital compared to available capital to determine capital adequacy. GAAP available capital for insurance operations would be adjusted consistent with the basis on which the jurisdictional capital requirement is computed
- State insurance regulators interact with Fed and FIO to identify existing risks at local and national level, discuss causes and how to mitigate; Fed, FIO and NAIC interact with IAIS similarly on an international level

GAAP – Generally Accepted Accounting Principles **FIO** – Federal Insurance Office

Creating a Practical Surveillance System for Global Insurance Industry

– ***IAIS Developing a Surveillance System for Global Insurance Industry***

- Principally focused on developing effective surveillance tools applied to individual insurers
  - o IAIS developing and testing a single comprehensive insurance capital framework to apply to individual insurers
  - o Challenge of single global framework – jurisdictional differences in insurance products, customs, and laws
    - IASB experienced same challenge with participating contracts – i.e., cannot develop a model that addresses wide variety of product attributes that exist globally to meet jurisdictional laws and consumer needs

– ***U.S. GAAP + Adjustments – Practical Solution; Capable of Implementing Quickly and Internationally***

- Critical elements of framework rely on communication and leveraging existing capital and solvency evaluation tools

Local

- U.S. NAIC RBC applied locally, focus on policyholder protection, identify existing risks, their cause and plans to mitigate based on coordinated interaction between insurers and local regulators
- For insurers not under Fed review authority, evaluation of "group" capital pursuant to Insurance Holding Company Act and Model Regulation. Leverage ORSA, Form F, and other tools as appropriate

National

- U.S. regulators (Fed and NAIC) and FIO adopt a national "surveillance" system for insurance "groups" based on NAIC RBC and other insurance tools (e.g., ORSA – including stress testing for P&C insurers and cash flow testing for life insurers), Form F, Supervisory Colleges, etc.) and non-insurance capital frameworks (e.g., Basel III, FINRA)
- Objective to identify risk in national insurance market requiring attention and individual insurers that exhibit risks requiring attention. Confidential discussions take place between regulators, FIO, and insurers and additional information and analysis is obtained/completed as necessary
- Conclude with approval of capital plans including dividends, buybacks, acquisitions/divestitures, etc.

International

- U.S. regulators and FIO meet with IAIS along with other jurisdictional regulators and share local and national information with IAIS to inform its international "surveillance" system
- Jurisdictional regulators and other parties (e.g., FIO) share key information about existing and emerging risks, status of key insurers, and general health and status of key insurance markets (i.e., P&C, Life, Health, Mortgage)
- IAIS uses jurisdictional information to assess status of international insurance market; existing and emerging risks associated with key insurance markets, geographies, and individual insurers (e.g., those designated as GSIIs, IAIG, etc.) and works with jurisdictional regulators and other key parties to develop strategies to monitor and mitigate the risk on an international basis

Integrating Jurisdictional Solvency Oversight with IAIS Global Surveillance System

– ***Benefits of GAAP + Adjustments as a Surveillance System Global Insurance Industry***
  - Proven effectiveness, speed to completion, and ability to enhance over time
    - o ***Proven Effectiveness***
      - ➢ Jurisdictional capital frameworks (e.g., US NAIC RBC) have proven track record
        - o Field-testing a global capital framework eliminated in lieu of calibrating jurisdictional capital frameworks
    - o ***Speed to Completion***
      - ➢ IAIS could focus on creating mechanisms to calibrate, aggregate and evaluate information about risks identified in local, national and international insurance markets
      - ➢ IAIS could create a "heat map" for the global insurance industry and identify areas where risks are emerging and where there is a need for coordinated discussions between national regulators (e.g., Fed and FIO), local regulators (e.g., NAIC, State Commissioners) and the IAIS
    - o ***Future Enhancements***
      - ➢ Once a primary "GAAP + Adjustments" factor-based capital adequacy measure is developed IAIS may develop additional tools for application on a confidential basis to individual insurers as follows:
        - o Additional stress testing for property casualty insurance companies outside of ORSA
        - o Additional cash flow testing for life insurance companies outside ORSA
      - ➢ IAIS might leverage and enhance other existing surveillance tools
        - o ORSA for identifying and understanding risks
        - o Supervisory colleges for collaboration and exchange of information

– ***Success Aided by Enhanced Communication and Leveraging Jurisdictional Frameworks***
  - NAIC RBC leveraged for U.S. domestic insurance activities, international capital frameworks for foreign insurance activities, Basel III for banking activities, SEC/FINRA for securities activities, and factor based approach for other non-regulated activities
  - Surveillance mechanism originates at local level, feeds into a national framework that aggregates NAIC RBC and other relevant capital frameworks which allows regulators to develop a "group assessment"
  - Local and national regulators interact with IAIS. IAIS aggregates information received and identifies and evaluates existing risks in international insurance market, discuss the nature of those risks and how they should be addressed/mitigated

Example: Computation of Tangible Equity on a Group Basis

	ICSCA	Insurance Components			Non-insurance Components			
		**	**	**	**	**		
	Group Capital Hybrid-Model (STAT+GAAP)	Domestic Insuers (NAIC RBC)	Foreign Insurers (Solvency II)	Foreign Insurers (Other Fmwk)	Bank (Basel III)	Other Regulated (SEC/FINRA)	Other Non-	Consolidated Group (GAAP Basis)
Required Regulatory Capital	**$ 6,000** (1)	**$ 3,000** (2)	**$ 1,000** (2)	**$ 1,000** (2)	**$ 1,000**	**$ -**	**$ -**	**$ 6,000** (3)
Available Insurance Equity Capital	**$ 18,000** (4) (5)	**$ 12,000**	**$ 3,000**	**$ 3,000**				
Available Non-insurance Equity Capital					**$ 2,000**	**$ -**	**$ 4,500**	
Non-insurance Equity Capital								
Non-insurance bank	$ 2,000							
Non-insurance non-bank (regulated)	$ -							
Other Non-insurance (non-regulated)	$ 4,500							
Insurance and Non-Insurance Equity Capital	**$ 24,500**							**$ 24,500** (4) (6)
Adjustments for tangible GAAP capital:								
Deferred costs - net of tax	$ (2,000)							$ (2,000)
Goodwill - net of tax	$ (500)							$ (500)
Tangible Equity	**$ 22,000**							**$ 22,000**
Deduct:								
Preferred stock	$ (2,000) (7)							$ (2,000)
Common Equity Tier 1 Capital	**$ 20,000**							**$ 20,000**
Add:								
Preferred stock	$ 2,000 (8)							$ 2,000
Qualifying hybrids	$ -							$ -
Total Tier 1 Capital	**$ 22,000**							**$ 22,000**
Add:								
Long term debt	$ 5,000 (8)							$ 5,000
Other	$ -							$ -
Total Tier 2 Capital	**$ 27,000**							**$ 27,000** (9)

Objective of ICS a "surveillance mechanism" - above additional information would reveal emerging issues

****** Calibration required to result in capital required at a common level.***

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EXAMPLE WILL NOT BE DISCUSSED DUE TO TIME CONSTRAINTS

NOTES:

(1) Under ICSCA, Fed must accept SAP financial information from U.S. insurers that prepare SAP only financial statements and has discretion to accept NAIC RBC in lieu of applying another existing framework or developing a new capital framework. NAIC RBC should be relied upon given its long (over two-decades) track record and the fact that it is undergoing continuous improvements (e.g., updating C-1 component, CAT, and operational risk, etc.).

(2) Objective to compute a capital requirement leveraging existing relevant frameworks (e.g., NAIC RBC, Solvency II, etc.) and for comparability, targeting a consistent "operating level of capital." Required insurance regulatory capital set at two times the authorized control level RBC as the ICS is viewed as a surveillance mechanism (i.e., to identify existing risks before they become critical).

(3) Initial group capital requirements calculated by combining required capital measurements for each subsidiary determined based on subsidiary's applicable capital framework. A Group Supervisor may adjust the combined group capital measurements for other non-financial activities, off-balance sheet items, and other risk factors. If Group Supervisor is U.S.-based, they would consider use of Form F information on Enterprise Risk as well as ORSA filing. ORSA components; Stress Testing for P&C and Cash Flow Testing for Life.

(4) SAP equity capital reconciled to GAAP equity capital. Reconciling items separately identified and regulators (NAIC, Fed, FIO, IAIS) discretionarily determine consequences.

(5) Combined available Statutory (SAP) insurance equity capital adjusted to avoid double counting of affiliate capital.

(6) Difference between SAP and GAAP equity capital for insurance entities relates primarily to impact of goodwill, DAC, unrealized on AFS securities, and reserve differences. For simplicity, SAP and GAAP equity capital assumed to include $2,000 of Surplus Notes issued by Domestic Insurers to Holding Company.

(7) Deduction necessary as Preferred Stock included in Other Non-insurance (non-regulated) equity capital.

(8) Assumes all capital instruments regardless of nature count as equity capital so long as by their terms, (a) they are subordinated to the claims of policyholders, (b) they contain features that are equity-like such as non-cumulative dividends, ability to defer interest payments, replacement capital covenants, etc., and (c) they have sufficient permanence.

(9) GAAP Adjustments for calculating GAAP Capital only use amounts that directly tie to audited GAAP financial statements or required SAP (SEC Regulation G requirement).

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