

Testimony of
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On Behalf of the National Association of Insurance
Commissioners

Before the
U.S. Senate Committee on Banking, Housing & Urban Affairs

Regarding:
Developments in Global Insurance Regulatory and Supervisory
Forums

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 United States 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 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

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.

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 non-recognition 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 U.S. 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

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, D.C. 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, D.C., at <https://www.federalreserve.gov/newsevents/speech/files/tarullo20160520a.pdf> (May 20, 2016).

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 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 two 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

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 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>

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 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 decision-making 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.