Purpose:

The purpose of this document is to articulate the views of U.S. state insurance regulators toward the uses of capital within prudential regulation and to help guide their ongoing work and input during the development by the International Association of Insurance Supervisors (IAIS) of a risk-based global insurance capital standard (ICS) for internationally active insurance groups (IAIGs), as well as straightforward, basic capital requirements (BCR) and higher loss absorbency (HLA) requirements for global systemically important insurers (G-SIIs). This document is also intended to identify the characteristics of such developments that are necessary for U.S. state insurance regulators to support their implementation in our national system of state-based insurance regulation. As these developments continue to evolve, this document will be updated and evolve as well.

Background:

In 2010, the IAIS began developing ComFrame as a comprehensive framework for the supervision of IAIGs. The IAIS has now agreed to develop a risk-based global ICS and to include it within ComFrame, which has always included a capital component within its solvency assessment. This component will be used as a starting point for development of the ICS. In 2014, the IAIS will also develop the BCR, which is planned to be finalized and ready for implementation by G-SIIs in late-2014. The BCR will serve as the foundation for HLA requirements for G-SIIs, which are to be implemented in 2019; it is anticipated that their development and testing will also inform development of the ICS.

U.S. Regulator Views:

Although U.S. state insurance regulators continue to have serious concerns about the timing, necessity, and complexity of developing a global capital standard given legal and regulatory differences around the globe, we intend to remain fully engaged in the process. Our objective is to ensure that should this standard be implemented, it appropriately reflects the risk characteristics of the underlying business and does not undermine legal entity capital requirements in the U.S. While we recognize the role and importance of group supervision, legal entity capital requirements are necessary to protect U.S. policyholders and promote a stable market, particularly given the structure of U.S. financial regulation. As U.S. insurance regulators work within the IAIS to develop and consider implementing the various capital proposals, we will be mindful of the cost/benefit of the proposed standards, the impact on insurance product availability and affordability or other market impacts, and the compatibility of the proposed standards with the U.S. insurance regulatory system.

The following general views guide U.S. state insurance regulators' overall approach and expectations towards the development of capital standards and the various international proposals:
Capital standards:

• U.S. state insurance regulators support the need to assess capital adequacy as part of coordinated solvency oversight and recognize that insurance supervisors in emerging markets are calling for basic international capital standards or benchmarks of some kind; however, a single uniform capital standard is not the silver bullet solution, but rather should be seen as one of many tools used to achieve more effective regulation and/or greater financial stability.

• The business model for insurance is significantly different than the business model for banking and even the business models and risk management approaches amongst insurers are unique. The track record in the banking sector of a reliance on capital standards did not prevent a system-wide banking collapse during the recent financial crisis. Development of an ICS needs to reflect the distinct characteristics of the insurance business model and its supervision.

• The risks inherent in insurance products, even for the same business line, can be very different jurisdiction to jurisdiction. A single risk charge for that business line may well lead to incorrect assessments of the relative capital strength of IAIGs.

Fungibility:

• U.S. state insurance regulators are also concerned with a reliance on the assumption that capital can be freely moved within an insurance group. It is critical that the free flow of capital (i.e. assets) across a group should not jeopardize the financial strength of any insurer in the group. As such, the flow of capital out of an insurance legal entity within the group should remain subject to required approvals by that entity’s regulator. Ultimately, whatever is implemented at the group level, this should be in addition to jurisdictional capital requirements. For the U.S., it will be in addition to, and not a replacement for, the U.S. Risk-Based Capital (RBC) that applies at the legal entity level.

• Other jurisdictions may allow for greater discretion of capital movement within a group if they believe it is appropriate for their markets and regulatory regimes. However, international standards should not favor one regulatory approach over another but rather focus on ensuring an outcome of appropriately capitalized insurance groups on the whole.

Regulatory diversity and coordination:

• There are stabilizing benefits to retaining diversity in regulatory approaches even as greater consistency is achieved. An over-reliance or over-confidence in a single capital standard or single regulatory approach could actually increase systemic risk as all insurers and regulators model their behavior around those standards.

• Supervisory colleges should serve as the central coordinating forum regarding the setting and assessment of group capital standards. The group-wide supervisor must actively communicate with other involved jurisdictions and coordinate decisions regarding the assessment of capital shortfalls.

Accounting and Valuation:

• There remain major differences among jurisdictions in accounting systems and approaches to valuation of assets and liabilities, as well as differences in regulatory objectives. As long as these differences exist, the development of an ICS, BCR and HLA will need to take this into account.
Timelines:

- U.S. state insurance regulators recognize these developments at the IAIS and have committed to work constructively towards the goal of developing an ICS that works for all jurisdictions. Nevertheless, all IAIS Members should recognize that these objectives are not easily achieved and will require significant resources over many years. Timelines for the various goals should be driven by the IAIS Members based on resources available and achieving high-quality results.

Backstop Capital Requirements (BCR):

- The goal of the BCR is to develop a common metric across various jurisdictional capital requirements at the group level for purposes of applying Higher Loss Absorbency (HLA), which will be the additional capital requirement for G-SIIs.

- The BCR will need to strike a balance between simplicity and risk sensitivity, with focus on achievability given the short timeframe for development. A factor based approach and/or the use of a leverage ratio should be considered.

Higher Loss Absorbency (HLA):

- The HLA should be developed for application to G-SIIs as a way to address systemic risk issues; as it has a very specific purpose, HLA should not be applied to insurers which are not designated as systemically important. As it is specific activities that are the focus of assessing potential systemic risk within the insurance sector, not traditional insurance business itself, the HLA should be developed in a manner that addresses those specific activities which may pose potential systemic concerns.

Insurance Capital Standard (ICS):

- A global ICS for IAIGs should be developed as something in addition to jurisdictional capital requirements. For the US, it would be in addition to the U.S. RBC that applies at the legal entity level; we do not intend for RBC to be replaced by any new group capital rules but rather augment our existing approach.

- It is important to have adequate capital at the group level, but this cannot be a substitute for having adequate capital at the legal entity level. Measurement of a global ICS should be against available capital resources (rather than existing jurisdictional requirements) on either an aggregated entity basis (bottom up approach) or a consolidated basis (top down approach). It should not be used to adjust jurisdictional entity requirements.

- A primary objective of a global ICS should be enhancing the efficacy of capital requirements in order to help facilitate solvency systems in developing markets be on par with, though not necessarily identical to, such systems in developed markets.