International Insurance Relations (G) Committee

Excerpt from the Proceedings of the NAIC

Louisville, KY
August 16 – 19, 2014
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INTERNATIONAL INSURANCE RELATIONS (G) COMMITTEE

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The International Insurance Relations (G) Committee met in Louisville, KY, Aug. 16, 2014. The following committee members participated: Michael F. Consedine, Chair (PA); Kevin M. McCarty, Vice Chair (FL); Thomas B. Leonardi, Immediate Past Chair (CT); Karen Weldin Stewart (DE); Gordon I. Ito (HI); James J. Donelon represented by Tom Travis (LA); Joseph G. Murphy represented by John Turchi (MA); John M. Huff (MO); Bruce R. Ramge represented by Christy Neighbors (NE); Kenneth E. Kobylowski (NJ); Benjamin M. Lawsky represented by Robert Easton (NY); Julia Rathgeber (TX); and Susan L. Donegan (VT). Also participating was: Monica J. Lindeen (MT).

1. **Heard an Update on the OECD**

Commissioner Lindeen reported that the Organisation for Economic Co-operation and Development (OECD) Insurance and Private Pensions Committee met in early June in Paris. She attended as part of the U.S. delegation, which is jointly led by the U.S. Department of Commerce and the Federal Insurance Office (FIO).

Commissioner Lindeen said she presented during the OECD Roundtable on regulatory factors affecting insurer long-term investing, focusing on outputs from monitoring of investments in the U.S., changes in corporate governance and ensuring board awareness of investment strategies, and the interplay between an open market in investment and how that affects RBC. Updates were provided on various projects that are currently under way, including work on analytical tools and the insurance sector, a preliminary report related to variable annuity products and their guarantees, a draft report on practices in disaster risk financing, and a draft outline for a report on investment strategies of insurers and long-term investment.

Commissioner Lindeen said that in mid-June, the OECD organized a seminar on Disaster Risk Financing in the Asia-Pacific Region. The conference was attended by officials and experts from the Asia-Pacific Economic Cooperation and other invited economies, regional and international organizations, and the private sector. Commissioner Donelon represented the NAIC at this meeting and discussed the following topics: the capacity of the insurance sector to cover disaster risks; the objectives, design and operation of key disaster insurance schemes; lessons learned and changes made to these schemes in light of recent disasters; effective approaches in regard to enhancing the availability and affordability of insurance; strengthening the capacities of the insurance sector to cover disaster risks; and how the U.S. has overcome implementation challenges.

Commissioner Lindeen noted that the OECD is organizing a seminar on Terrorism Risk Insurance Sept. 10 in Washington, DC, at the Treasury Department. Commissioner Murphy will represent the NAIC at that meeting.

2. **Adopted its Aug. 7, July 24 and April 23 Minutes**

Commissioner Kobylowski made a motion, seconded by Commissioner McCarty to adopt the Committee’s Aug. 7 (Attachment One), July 24 (Attachment Two) and April 23 (Attachment Three) minutes.

3. **Discussed the Activities of the IAIS**

a. **Restructuring and Reorganization**

Commissioner McCarty reported on the restructuring and reorganization taking place at the International Association of Insurance Supervisors (IAIS). He noted that in 2013, the IAIS began a review of its strategic goals, financial outlook and resources, with the goal of developing proposals to improve its structures, operations and the allocation of resources, including improving the process for obtaining and enhancing the quality of stakeholder input. He said that earlier this year, the IAIS Executive Committee approved several restructuring changes. In looking at the variety of workstreams taking place at the IAIS and considering its priorities and limited resources, reorganizational decisions resulted in existing groups being combined, refocused, dissolved or left the same. These changes are being rolled out mostly this summer, with some changes taking effect by the end of the year.
Commissioner McCarty said that while the IAIS Executive Committee recognized that the IAIS has benefited greatly from the contributions of Observers and other interested stakeholders to its work, it was also recognized that the process of obtaining stakeholder input could be more effective and efficient. He said that to maximize the opportunity for timely, substantive and high-quality input from Observers and other stakeholders, the Executive Committee agreed to update relevant procedures. As part of these reforms, Commissioner McCarty said it is being proposed that Observers would no longer generally participate in meetings but rather be invited when necessary to provide targeted, technical input. The Executive Committee also agreed to increase the IAIS’ engagement with Observers and other stakeholders through special Executive Committee sessions, increased Committee-level hearings, greater publication of background documents and the use of conference calls at certain stages of policy development.

Commissioner McCarty noted that the IAIS has released for consultation draft procedures for meeting participation and the development of supervisory and supporting material and a draft Policy for Consultation with Stakeholders. He said that comments are due on these procedures and policy by Sept. 2, and he encouraged interested parties to submit their comments to the IAIS on this proposal. He said that the NAIC and state regulators’ ideas of how to make stakeholder input more effective, consistent, transparent and predictable differ from many fellow IAIS members and that NAIC members participating at the IAIS have for years been trying to make the IAIS a more open and transparent organization. Commissioner McCarty said that some of the solutions being proposed are a step in the wrong direction, specifically Observer participation in meetings, and that some proposals need further clarification, which will hopefully come as a result of the current consultation.

George Brady (IAIS) invited interested parties to submit their best ideas regarding how the IAIS takes input from stakeholders. He said there would be a change in the approaches to the IAIS’ current “pay to play” structure in addition to changing the automatic attendance policy by stakeholders at IAIS meetings. He said that IAIS field testing was an example of how the IAIS process involved targeted stakeholders.

Commissioner Leonardi said that state regulators have been vocal in opposition to this change at the IAIS. He said the NAIC is much more open and transparent by comparison and is trying to be even more so, whereas the IAIS is going in the other direction.

Tracey Laws (Reinsurance Association of America—RAA) said the IAIS field testing was not an ideal process as a few get the benefit of participating in something that will end up affecting many. She was not opposed to changes in the IAIS’ “pay to play” structure; however, she hopes to coordinate comments with the NAIC on the IAIS proposal to change stakeholder access to meetings.

Robert Neill (American Council of Life Insurers—ACLI) noted that the ACLI has participated in meetings at the IAIS since its inception and that the ACLI wants to make changes to the IAIS proposal that make sense and to improve the procedures as currently drafted.

David Snyder (Property Casualty Insurers Association of America—PCI) questioned how the IAIS would go about selecting stakeholders for targeted input and suggested that this change would create competition not of ideas, but rather competition for inside influence.

Birny Birnbaum (NAIC Funded Consumer Representative and Center for Economic Justice—CEJ) encouraged the IAIS to create a more formal structure for consumer participation. He said the NAIC has been responsive in explaining reasons for closing a meeting, and the criteria for closing meetings or for inviting specific stakeholders need to be specified by the IAIS so that more diverse stakeholders, including consumers’ representatives, can be involved. He said this process should not be totally discretionary and subjective.

Amanda Greenwold Wise (American Insurance Association—AIA) said that a change in stakeholder participation at this stage of the ongoing work with ComFrame will be detrimental and that field testing is not a proxy for transparency of process.

Jeff Alton (CNA Financial) noted concerns about developing a common capital standard at the IAIS if access to meetings is only available to a select few and wondered whether the IAIS’ practice of holding closed-door meetings with think-tanks would continue. He asked how information would be disseminated to stakeholders during the standards-setting process. Other international standard setting bodies such as the International Accounting Standards Board (IASB) offer up to six months for the industry to comment on their proposed standards.
Mr. Brady responded that the purpose of the IAIS stakeholder proposals being out for consultation was to seek the best ideas on this topic and identify points that needed clarity, and he encouraged interested parties to submit comments.

Sonja Larkin-Thorne (NAIC Funded Consumer Representative) said that the NAIC encourages people to engage in its processes and was critical of the IAIS proposal to close participation, noting that given the impact the IAIS’ work can have on U.S. consumers and stakeholders who have no say in electing the IAIS, it should be more transparent and open.

Doug Barnert (Barnert Associates) noted that the IAIS has opened up its process over the past 15 years and that other international bodies had followed its lead, but the proposal to now close its sessions was an unfortunate reversal in direction.

Commissioner Stewart said that as the largest delegation at the IAIS, the U.S. state regulators should have a loud voice at the table and be more proactive and assertive on this issue.

Commissioner Consedine noted that National Conference of Insurance Legislators (NCOIL) has also expressed concerns about the lack of transparency at the IAIS.

b. Financial Stability Committee

Commissioner Kobylowski reported on the Financial Stability Committee at the IAIS. He explained that the IAIS Financial Stability Committee is in the process of its annual review to identify global systemically important insurers (G-SIIs), and that the assessment methodology involves both quantitative and qualitative elements. This annual review will also consider the systemic importance of some companies that have significant reinsurance operations. He added that it is expected that the Financial Stability Board (FSB) and national authorities, in consultation with the IAIS, will make determinations on the G-SII status of insurers and reinsurers in November.

Commissioner Kobylowski said that the IAIS is working on higher loss absorbency (HLA) capital requirements for G-SIIs. The first step in the process has been the development of a basic capital requirements (BCR) that will serve as a base upon which the HLA requirements will build. He noted that in light of the limited time frame for delivering on the BCR, the requirement is intended to be a straightforward calculation and largely a factor-based approach to determining capital, with limited risk granularity. Early last month, the IAIS released its second consultation document on the BCR, which contained significantly greater detail on the calculation of the BCR than the first consultation document, but still left open several issues that require decision before the BCR design is finalized. He commented that the NAIC and several U.S. interested parties provided comments on the consultation document. He said it is expected that the IAIS will refine the proposal in the coming months based on the comments received and will deliver the BCR to the Group of Twenty in time for its November 2014 Summit. He added the IAIS hopes to have a first consultation on the HLA in December and is targeting a final proposal for the end of 2015. Both the BCR and HLA would not to apply to G-SIIs until 2019, so there is time for review and refinement.

Commissioner Kobylowski said that last year, the IAIS committed to develop a risk-based global insurance capital standard (ICS) to be included in ComFrame, to be applicable to all internationally active insurance groups (IAIGs). The IAIS has begun initial development on the ICS, also on a tight time frame, with an ICS proposal expected by the end of 2016. He noted that implementation of ComFrame, including the ICS, is also scheduled to begin in 2019, and it is expected that the ICS will eventually replace the BCR as the base to which HLA is applied.

Commissioner Kobylowski noted that besides the work on capital, the IAIS is progressing on other policy measures for G-SIIs as well, including guidance on liquidity management and planning for G-SIIs, which will be revised based on comments from a recent consultation period and up for approval by the IAIS this fall.

c. Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame)

Commissioner McCarty said the ComFrame document was finalized in June after final edits were proposed by the ComFrame Draft Review Group and reviewed by the relevant IAIS subcommittees. He stated ComFrame is currently subject to field testing and reported the following: Module 1 has been completed; the quantitative aspect of Module 2 will continue through 2016; the qualitative aspect of Module 2, risk management and corporate governance, will commence field testing in October 2014, and Module 3, supervisory processes, including supervisory colleges, is scheduled for field testing commencing in 2015. As the ComFrame document itself is now revised for field testing purposes, Commissioner McCarty
said he will provide updates on this important workstream through reports of the ComFrame Development and Analysis Working Group.

4. Received the Report of the ComFrame Development and Analysis (E) Working Group

Commissioner McCarty reported that the ComFrame Development and Analysis (G) Working Group met earlier in the day and received an update on the ComFrame field testing process and the various IAIS capital developments (Attachment Four). He noted that the Working Group heard a recap of the International Capital Standards Forum held on Aug. 15, the purpose of which was to have an interactive discussion on the development of the ICS, focusing on potential goals, benefits/consequences, realities and potential approaches for developing a global ICS. The forum had more than 200 participants, and views, comments and questions were heard from state regulators, federal colleagues, state legislators, consumer representatives and the industry. He added the forum highlighted several important issues, noting it was intended to be just the beginning of the discussions and of the work to be done.

Commissioner Leonardi said there is a tremendous need for industry to coalesce around a proposal for a capital standard that can be moved forward with the help of the Federal Reserve and that works for the U.S. market and regulatory approach.

5. Heard an Update on International Regulatory Cooperation Activities

Commissioner Ito reported on significant ongoing regulatory cooperation work, including various international training programs. Earlier this month, several commissioners, regulators and NAIC staff were in Bangkok for the 5th Annual U.S. Insurance Regulation and Supervision Seminar on Solvency Monitoring and Risk Governance hosted in conjunction with Thailand’s Office of Insurance Commission. Including the host country delegations, the forum welcomed more than 60 participants from Bhutan, Brunei, Cambodia, Indonesia, Japan, Laos, Malaysia, Philippines, Singapore, Sri Lanka and Vietnam.

In late July, Commissioner Lindeen, Pam O’Connell (CA) and NAIC staff joined insurance regulators from Latin America at a seminar in Santiago, Chile, focusing on insurance regulation and supervision of market conduct in the U.S. The seminar was jointly organized by the NAIC, the Association of Latin American Insurance Supervisors, and the Chilean Securities and Insurance Supervisor.

Commissioner Ito said the International Fellows program is celebrating its 10-year anniversary in 2014. In early October, the NAIC will welcome 13 International Fellows from seven countries, including China, India, Nigeria, Pakistan, Saudi Arabia, Taiwan and Thailand. Fellows will be hosted by California, the District of Columbia, Georgia, Hawaii, Iowa, Louisiana, Missouri, Nevada, New Jersey, Pennsylvania and Texas. He also noted that in September, the NAIC is organizing an invitation-only event in Hawaii, which will bring together insurance supervisors and insurance industry leaders from the Asia-Pacific region. The program will include speaker panels and small group discussions covering current and emerging topics, such as capital standards, group supervision, reinsurance and catastrophe events.

6. Heard an Update on U.S.-EU Insurance Dialogue Project

Commissioner Consedine provided some background on the U.S.-EU Insurance Dialogue Project, which is a joint project between the NAIC, FIO, the European Commission, and European Insurance and Occupational Pensions Authority to enhance the mutual understanding of each other’s approach to solvency oversight and to explore ways to increase transatlantic cooperation. In December 2012, a joint report was issued along with a set of common objectives and initiatives, many of which are already under way or under consideration within the NAIC process at one or more committees or working groups.

Commissioner Consedine noted that in July, the U.S.-EU Steering Committee agreed to a revised Way Forward document identifying key priority areas, including confidentiality, group supervision, reinsurance collateral and pathways forward. It also reflects recent developments and progress achieved to advance mutual understanding and recognition of the different regulatory tools and approaches used by the U.S. and Europe.

Commissioner Consedine said the mechanisms for exchanging confidential information continue to be a major discussion point. While both the U.S. and European Union (EU) support the IAIS Multilateral Memorandum of Understanding (MMoU), some have indicated a preference for another MMoU or bilateral agreement in this area. According to the Way Forward document, it was agreed to “identify by the end of 2014 the merits of an additional trans-Atlantic bilateral
agreement, including the optimal structure(s) of such an agreement to further facilitate the exchange of confidential information through a covered agreement or other mechanisms identified by the Steering Committee.” He noted that at this stage, such work remains exploratory and is in no way a commitment to one approach or the other.

Regarding group supervision, Commissioner Consedine said that while the NAIC has made no commitments in this area, the updated Way Forward document contemplates the potential use of a covered agreement to affirm the U.S. system of group supervision.

Commissioner Consedine said the use of a covered agreement to address U.S. reinsurance collateral requirements has been incorporated into the Way Forward document, indicating that the EU, and Treasury/FIO with the consultation of state insurance regulators, will take initial steps toward a covered agreement by the end of 2014, which would be based on the NAIC Credit for Reinsurance Model Law and Regulation. He said it bears repeating, however, that the Way Forward document does not commit the NAIC to any one approach but calls for further exploration of all these issues. He said that in July, the NAIC leadership met with representatives of the United States Trade Representative (USTR) and the Treasury Department to discuss the concept of a covered agreement to address U.S. regulatory objectives with foreign jurisdictions. Although several important U.S. priorities were discussed, many unanswered questions remain, and more details are needed about the timing, scope and degree of state insurance regulator involvement in pursuing such an agreement. He added that the NAIC anticipates further discussions with the Treasury Department and the USTR as this concept develops to determine whether the pursuit of an agreement is in the best interest of U.S. policyholders and insurers.

Commissioner Consedine said that while this U.S.-EU Insurance Dialogue Project has been constructive, it remains unclear how U.S. firms will be treated by the EU under Solvency II. Nevertheless, he noted the NAIC was looking forward to continuing this important dialogue and to further discussing the long-term objectives of this project and the potential impact on transatlantic insurance markets. He noted that on Oct. 25, the NAIC—along with FIO, EIOPA and others—is organizing a public event on the evolution of group supervision in Amsterdam at the end of the IAIS annual conference, which should be a useful and informative exchange among key regulatory and industry representatives from the U.S. and Europe.

Senator Ben Nelson (NAIC) hoped the mutual recognition process will result in a positive result for the U.S. system from the EU, but he noted concerns that recognition limited to a period of five years would create challenges of needing continual work rather than providing a degree of certainty. He said the Way Forward represents mutual aspirations and that progress will not occur without a continuing dialogue, which he said had been frank and friendly.

Mr. Easton asked if the EU had articulated why it is proposing mutual recognition to be limited to five years. Sen. Nelson replied that under Solvency II, there are a series of steps for a jurisdiction to go through and that the EU views the five-year time frame as a way for the U.S. to bypass a more onerous path to mutual recognition. Sen. Nelson said the NAIC would continue to insist that the U.S. insurance regulatory regime warrants permanent, not time-limited, recognition.

Ms. Laws said the RAA is pleased with the revised Way Forward, which is important for U.S. companies, and she encouraged state regulators to continue to remain engaged in the process as the prudential regulators.

7. **Heard an Update on the Joint Forum**

Mr. Easton reported that the Joint Forum Plenary met at the end of June and discussed a variety of topics. He said that while the IAIS and the International Organization of Securities Commissions (IOSCO) have already agreed to the continuance of the Joint Forum, the Basel Committee (BCBS) was less supportive and will be making a decision about endorsement in September. A note on the strategic direction of the Joint Forum will be prepared and presented to the BCBS in September; were they not to endorse, the Joint Forum would wind itself down by the end of 2015.

Mr. Easton said that as a result of the BCBS failure to endorse prior to Plenary, the Joint Forum did not propose definitive new work pending the outcome of the BCBS meeting in September. A strategic group will write up thoughts on data, bail-in tools and the effects on other sectors, and financial innovation. It will also address internal governance of the Joint Forum, composition, extended membership and communication with parent committees.

Mr. Easton said the reports on the pilot exercise on the implementation of the financial conglomerate principles, and on supervisory colleges, were agreed and have been sent to the parent committees for approval. There was much discussion about the current report on asset encumbrance, and it is being restructured this summer. However, there were calls for more data and analysis, which is likely to be challenging given that the report must be evidence-based.
Mr. Easton said the work on credit risk management is addressing some interesting points, including whether, and if so the degree to which, any failure of a centralized counter party may be systemic. The workstream also has cross-over work with the asset encumbrance workstream, as increased attention to derivatives has led to an increase in initial margin and, therefore, the need for high-quality liquid assets for collateral purposes.

8. Discussed Other Matters

Commissioner Consedine reported on the International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP), which is a comprehensive assessment of all sectors of each country’s financial regulatory regimes. For the insurance sector, the IMF will assess U.S. compliance with the IAIS’ 26 Insurance Core Principles (ICPs). In 2010, the IMF assessed the U.S. financial regulatory system, and the insurance system was deemed “observed or largely observed”—the highest levels of evaluation—for 25 of the 28 ICPs. He said past performance on the FSAP demonstrated the overall strength of the U.S.’ state-based insurance regulatory system, especially during the global financial crisis. He added that the next IMF assessment of the U.S. system is currently under way, and state regulators and NAIC staff are working closely with federal counterparts in order to complete the process in 2015.

Mr. Brady urged attendance at the upcoming IAIS annual conference in Amsterdam Oct. 22-24.

Having no further business, the International Insurance Relations (G) Committee adjourned.
International Insurance Relations (G) Committee
Conference Call
August 7, 2014

The International Insurance Relations (G) Committee met via conference call Aug. 7, 2014. The following Committee members participated: Kevin M. McCarty, Vice Chair (FL); Karen Weldin Stewart (DE); James J. Donelon (LA); John M. Huff represented by John Rehagen (MO); Bruce R. Ramge (NE); Kenneth E. Kobylowski (NJ); Benjamin M. Lawsky represented by Martha Lees (NY); Julia Rathgeber represented by Doug Slape (TX); and Susan L. Donegan (VT).

1. Adopted NAIC Comments on IAIS Draft Consultation Documents

Commissioner McCarty noted that he would chair the meeting in the place of Commissioner Michael F. Consedine (PA), and he introduced the four draft papers from the International Association of Insurance Supervisors (IAIS) out for consultation. He said relevant NAIC groups and NAIC staff had drafted comments on each paper, and these were sent to Committee members and interested parties in advance of the conference call (Attachment One-A).

a. Application Paper on Approaches to Conduct of Business Supervision

Commissioner McCarty introduced the application paper on approaches to conduct of business supervision, which the IAIS Market Conduct Subcommittee drafted to identify approaches to conduct of business supervision that insurance supervisors may wish to consider when implementing the related components of Insurance Core Principle (ICP) 9 (Supervisory Review and Reporting) and supervising compliance with the requirements of ICP 19 (Conduct of Business). The paper aims to provide a useful source of ideas, examples and tools to supervisors in supervising conduct of insurance business. He noted that members of the Market Regulation and Consumer Affairs (D) Committee and NAIC staff reviewed and provided draft comments. He commented that the Committee seemed comfortable overall with the paper as the approaches and examples presented were relevant and beneficial to supervisors and added that the comments as drafted provide some minor editorial suggestions.

David Snyder (Property Casualty Insurers Association of America—PCI) mentioned several comments PCI planned to submit, including how enforcement penalties should match the severity of the offense and how protections for consumers may vary by product line as appropriate.

b. Issues Paper on Anti-Bribery and Corruption

Commissioner McCarty introduced the issues paper on anti-bribery and corruption, which the IAIS Financial Crime Working Group drafted to explore how bribery and corruption affects the insurance market, as well as how insurance supervision can help to ensure that insurers and insurance intermediaries manage such risks effectively. The paper discusses: 1) the relevance of bribery and corruption to the insurance sector; 2) the relationship between measures to combat bribery and corruption and frameworks for anti-money laundering/combating the financing of terrorism; and 3) the insurance supervisor’s role in combating bribery and corruption.

He stated that members of the Market Regulation and Consumer Affairs (D) Committee, the Antifraud (D) Task Force and NAIC staff reviewed and provided draft comments. The two main comments were in response to questions included in the consultation: 1) to the extent the ICPs could better address financial crimes more broadly, it would be most appropriate by adding additional guidance to the relevant ICPs rather than expanding an existing ICP or creating a new one; and 2) the paper highlights warning signs and ways to manage risks of bribery and corruption, so deciding on whether more work by the IAIS is necessary should be reassessed later, sometime after the issues paper has been published.


Commissioner Kobylowski presented the Guidance on liquidity management and planning, which the IAIS Financial Stability Committee prepared. He explained that the policy measures for global systemically important insurers (G-SIIs) that the IAIS released in July 2013 state that group-wide supervisors should require G-SIIs to have adequate arrangements in place to manage liquidity risk for the whole group, and that G-SIIs should develop liquidity risk management plans. The purpose of this document is to provide guidance to group-wide supervisors in the application of these requirements to G-SIIs.
He noted that members of the ComFrame Development and Analysis (G) Working Group and NAIC staff reviewed and provided draft comments highlighting the importance of liquidity plans being tailored to an insurer’s specific business operations and, thus, the appropriateness of the paper providing principles-based guidance on what would be expected from G-SIIs. A second comment identifies a potential contradiction within the paper related to liquidity sources and suggests a potential solution.

d. BCR Consultation Paper

Commissioner Kobylowski introduced the basic capital requirements (BCR) consultation paper that the IAIS Technical and Financial Stability Committees jointly prepared to solicit input regarding the development of the BCR, requirements that are expected to apply to G-SIIs from 2015 or shortly thereafter. He noted that feedback was being solicited on this second consultation document to facilitate the design and calibration of the BCR proposal, which will be delivered to the G20 summit in November. Members of the ComFrame Development and Analysis (G) Working Group and NAIC staff reviewed and provided draft comments on the BCR document. He added that the American Academy of Actuaries (AAA) provided its comments on the BCR in advance of the call (Attachment One-B), but otherwise no additional comments were received. Lou Felice (NAIC) described the draft NAIC comments and noted that the level of the BCR is being targeted using two metrics: 1) the ratio of BCR to jurisdictional prescribed capital requirements (PCR), which has a regulatory focus; and 2) the capital held over the BCR, which has a financial strength focus.

Rob Esson (NAIC) noted that while market adjusted valuation approach was used during the initial testing of the BCR, there are concerns about the use of this approach extending into the development of the global insurance capital standard (ICS), especially as such an approach is inappropriate for use for insurers with significant long-term business portfolios. Commissioner McCarty suggested the draft comment on valuation be amended to reinforce this concern.

Jeff Alton (CNA Financial) noted concern over the timing of development of the BCR and that unlike normal IAIS papers, the BCR is being finalized with several important issues still undecided, such as the alpha ratio scaler and treatment of discount rates. Ryan Workman (NAIC) responded that the NAIC comments include the need for further refinement to the BCR and the potential need for additional consultations in the future.

Mr. Snyder commented that Robert Litan (The Brookings Institution) had recently published a paper, “Worrisome Trends in Solvency Regulation of Insurance Groups in a Post-Crisis World,” which was relevant to the discussions taking on the BCR and other international developments.

Steve Broadie (PCI) noted his concern with the BCR’s use of tiered capital, a concept that is also included in ComFrame, and asked whether that could be reexamined. Mr. Felice responded that the BCR is a ratio that will be used as a base for the higher loss absorbency (HLA) requirement for G-SIIs and that because a G-SII may pose a systemic risk, it is important that the HLA require the highest quality of capital.

Ralph Blanchard (Travelers Companies) commented on the distinction between core and additional capital and expressed concern on how subordinated debt and surplus notes are classified. Ramon Calderon (NAIC) noted that there had been discussion at the IAIS on the need to give consideration to downstream payments within a group. He added that in the United States, there is a strong supervisory approval process, so subordinated debt treated as capital is available for the payment of policyholder and creditor obligations and should be treated accordingly. Commissioner McCarty suggested that the draft comments be amended to elaborate on this point.

Commissioner Kobylowski made a motion, seconded by Commissioner Stewart, to submit the NAIC comments, including the two suggested amendments on the BCR comments, to the IAIS on its four papers out for consultation. The motion passed.

2. Discussed Other Matters

Commissioner McCarty said there will be an International Capital Standards Forum at the Summer National Meeting to discuss the development of international capital standards in an open dialogue amongst regulators and interested parties. He also said the Committee will meet at the Summer National Meeting to continue work on its goals.

Having no further business, the International Insurance Relations (G) Committee adjourned.
The Application Paper does a very good job of describing various approaches to conduct of business in the context of ICs 9 and 19 and the explanations and examples provided are relevant and beneficial to supervisors. The explanations and examples highlight the variety of ways in which supervisors can achieve similar outcomes for sound business practices and policyholder protection.

A word and a period seem to be missing in the first sentence; suggest: “Material and persistent failure to manage COB risks may increase an insurer’s exposure to reputational, legal and regulatory risks and ultimately threaten an insurer’s soundness and sustainability.”

To be consistent with IAIS wording, the survey response box at the end of paragraph 119 should read “…a range of supervisory practices including off-site monitoring and on-site examinations.”

Third bullet, need a space in “…resolution. Sometimes…”

Ninth bullet, IAIS wording uses off-site monitoring and on-site inspections so suggest for consistency, “Post-investigation or follow-up examinations” should read “Post- or follow-up inspections.”

In the second sentence, “customers” should be singular: “…information provided by a customer prior to the conclusion…”

“insurers” should be “insurers.”
This Issues Paper does a good job in illustrating how bribery and corruption may affect insurers and insurance intermediaries as well as highlight what insurance supervision can do to help to ensure that insurers and insurance intermediaries manage such risks effectively.

Consultation question on whether the ICPs should address combating financial crime in insurance from a broader perspective:

The Issues Paper highlights that bribery and corruption is an issue that may affect insurers and is something supervisors need to be aware of to ensure that insurers manage such risks effectively; however, we do not feel that the IAIS needs to do much further in addressing financial crime more broadly in the ICPs. The ICPs appropriately address fraud and AML/CFT because, given the nature of insurance products, insurers are more susceptible to these particular crimes and the risks they present. As one gets into financial crime more broadly, the implications to insurance become more generalized and the direct role of insurance supervisors lessen. To the extent the ICPs could better address financial crimes more broadly, it would be most appropriate by adding additional guidance to the relevant ICPs rather than expanding ICP 21 or creating a new ICP.

Consultation question on whether this paper could be expanded into an Application Paper:

To some degree, this paper already highlights warning signs and ways to manage risks of bribery and corruption. The question of whether more work is necessary at this point needs to take into consideration other IAIS priorities and the limited resources as well as the extent to which other relevant organizations may already be doing similar work to avoid duplication. Given these points and the fact that the IAIS has yet to publish this paper, we suggest it is too soon to decide on whether more is necessary and suggest reassessing this issue in a year or two.
Comments template for: “Guidance on Liquidity Management and Planning, draft, 26 June 2014”

Please email your response to bernhard.mayr@bis.org no later than 8 August 2014

Name of respondent: National Association of Insurance Commissioners
Organisation: National Association of Insurance Commissioners
Disclosure of comments: Yes

<table>
<thead>
<tr>
<th>Section in paper</th>
<th>Comment</th>
</tr>
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<tbody>
<tr>
<td>General</td>
<td>It is critically important that liquidity plans be tailored to an insurer’s specific business operations and that an insurer ‘own’ its liquidity plans. As such, we are sensitive to sections of the paper that provide lists of specific items to be considered or suggestions that such plans be provided in a specific form to the supervisors. However, we recognize that the stated purpose of the document is to provide principles-based guidance on what would be expected from G SIs, and thus we are generally supportive of the content in that context.</td>
</tr>
<tr>
<td>Section 3 Concepts (also applies to Section 4.2 Plans for Execution, Liquidity Analysis)</td>
<td>Towards the bottom of page 4, a list of bullets of liquidity sources includes two at the end of the list: “Receipt of liquid assets as collateral for derivatives and other transactions” and “collateral held under reinsurance agreements”. The paper correctly indicates that the level of liquidity of the sources listed (including the two above) varies and can be circumstance-specific. The paper then goes on to say, “Also, encumbered assets cannot be counted as liquidity sources”. Given that the last 2 bullets under liquidity sources might be considered types of encumbered assets, this statement may be contradictory to these bullets. To address this, we suggest adding the following language to the sentence “Also, encumbered assets cannot be counted as liquidity sources unless their liquidity is triggered by contractual terms in specific circumstances or stress conditions being assumed.”</td>
</tr>
</tbody>
</table>
The 2nd BCR Consultation Paper contains much more detail on the construction of the BCR than the first. However, a number of key aspects and related decisions still need to be addressed in order to allow supervisors, designated G-SIIs and other observers to assess the impact of the BCR (and a BCR ratio). In particular, the average ratios of BCR to PCR and Capital Resources to BCR require further analysis over the summer and possible revision. In order to provide informed comments on a number of related decision points regarding different parts of the formula it is suggested that the components of the BCR be addressed in the following order:

a. BCR Factors and results must be further analyzed to establish a meaningful starting point for measurement of the BCR requirements against existing PCRs and against qualifying capital resources:
   - Data from all G-SIIs should be included
   - Refinements may be required to the BCR factors based on the full data set; review of volunteer proxy data and segmentation for accuracy and consistency; and a better understanding of the accounting differences.

b. Jurisdictional PCRs must be normalized to reflect consistent measure of loss absorbency:
   - Consistency in whether jurisdictional PCR is provided pre or post diversification benefits must be established.
   - In addition to moving reserve conservatism (e.g. MOCE) to capital resources, MOCE could also be recognized as an element of jurisdictional PCR in order to reflect the excess loss absorbency that is locked in insurance liabilities proxies (this is related to the accuracy of the current estimate) presented in developing and applying the BCR factors.

c. Core and qualifying capital resources numbers must be analyzed and further developed:
   - The data and values for qualifying and core capital must be reviewed for reasonableness and consistency across firms.
   - The level of MOCE should be verified for further discussion of the impact on capital resources and any removal or transfer of MOCE from capital resources should be deferred.

d. The Alpha should be determined only after the other BCR components are close to being finalized:
   - Focusing on the ratio of capital resources to BCR at the beginning of the process is not a sufficient rationale to adjust the alpha at this point and it should remain at 1.
   - The alpha should be the last component that is addressed. Calibrating via use of the alpha can only be intelligently discussed after we know the impact of a refined BCR; verify jurisdictional PCRs; and have a full picture of what comprises capital resources. That will foster informed discussion and analysis by firms and supervisors as to where the BCR actually sits relative to both jurisdictional PCR and capital resources.

The consultation paper references refinements during the initial reporting periods of 2015 and 2016. The NAIC supports the notion of continuing refinements, but strongly supports using the maximum opportunity for initial refinement of the
<table>
<thead>
<tr>
<th>Section</th>
<th>Paragraph</th>
<th>General Comments</th>
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<tbody>
<tr>
<td>Section 2.1</td>
<td>Overview</td>
<td>2. The NAIC strongly supports the position in the paper that the BCR in its current form will only apply to G-SIIs and solely as the base for a combined BCR + HLA capital standard.</td>
</tr>
<tr>
<td>Section 2.2.3</td>
<td>Capital Resources</td>
<td>3. The paper's references to calibration are not clear as to intent. An explicit target calibration does not seem possible for the BCR so calibration seems to be used in reference to a target based on either existing jurisdictional capital requirements or relative to capital resources. Thus these references all point back to the alpha (see comments #1d and #14 regarding the alpha adjustment). That point should be made more explicit in the document.</td>
</tr>
<tr>
<td>Section 4</td>
<td>Qualifying Capital Resources</td>
<td>4. Consolidated Capital Requirements: The references to consolidated capital requirements vs. group wide capital requirements are unclear. The paper notes that there are three components that comprise the BCR (insurance, banking and other NINB). Further there are references to adjustments to align capital resources with the approach followed for the construction of the BCR capital requirements. While the BCR ratio in the consultation paper appears to measure consolidated capital resources number in the numerator divided by the combination of the three BCR components in the denominator, there are still questions about whether certain non-financial NBNI activities will be subject to specified capital requirements in the BCR or will be addressed through a “framework that includes a qualitative analysis” (see paragraph 43). In that vein it may be that to the extent feasible each component of the BCR should have its own sufficiency ratio to improve assessment of each industry segment’s capital adequacy. NAIC supports further discussion and clarity on this point.</td>
</tr>
<tr>
<td>Section 2.2.3</td>
<td>Paragraph 23</td>
<td>5. BCR Ratio: Since the BCR by itself is not a capital standard without HLA, the BCR ratio without HLA is therefore less meaningful and possibly unnecessary. However if a BCR ratio alone is to be reported it should be based on a numerator that includes all qualifying capital resources consistent with a base capital requirement and a core capital threshold (i.e. 50%) as contemplated in ComFrame. If desired to prepare for HLA a second ratio based on just core capital ratio could be added for informational and compliance purposes. When finalizing a BCR + HLA ratio, the NAIC supports using a 50% threshold of core capital for the BCR portion and a 100% threshold for the HLA portion of the combined capital standard for G-SIIs.</td>
</tr>
<tr>
<td>Section 2.3</td>
<td>Paragraph 26</td>
<td>6. BCR/ICS Timetable: The chart on page 10 does not include a reference to further consultation on HLA beyond December 2014. NAIC would support including the potential for a 2nd consultation paper in 2015.</td>
</tr>
<tr>
<td>Section 3.1</td>
<td>Paragraphs 32</td>
<td>7. Reporting of the BCR Ratio: Confidential reporting of the BCR ratio should continue until HLA is added. There should be strong disincentives for use of the BCR on its own by G-SIIs as an indicator of financial strength at least until HLA is required in 2019.</td>
</tr>
<tr>
<td>Section 3.4</td>
<td>Paragraph 36</td>
<td>8. Insurance Factors: As supported in our general comments, there should be a strong connection between this section and the data refinement</td>
</tr>
</tbody>
</table>
effort described generally in the Paper and that these factors are subject to revision before a final recommendation is adopted by the IAIS. They are not final at this point.

**Section 3.5 Paragraphs 40 and 41**

9. Basel III Entities and Basel-Like Activities of Unregulated Entities:

NAIC would support the most appropriate measure (e.g. either the Leverage Ratio or Basel Risk Weighted Assets) being applied to Basel III subject activities. That measure could be different for regulated Basel III entities and unregulated entities conducting the activities, but should be consistent for all regulated entities and consistent for all unregulated entities rather than using a “greater of Leverage ratio of full Basel III” option.

**Section 3.5 Paragraphs 42 and 43**

10. NINB Financial and non-Financial Activities:

Regarding paragraph 42, the alternative approach of 25 basis points on off balance sheet assets for NINB financial activities has not been adequately vetted and its rationale has not been made clear. Paragraph 43 calls for applying an operational risk charge in the BCR for non-financial activities (as an alternative to a qualitative assessment). This also needs to be considered further, as do the appropriate proxies upon which to base such a charge. NAIC supports further deliberation of options for this component of the BCR. (See also our comment #3 on consolidated capital requirements)

**Section 4.3 Paragraph 52**

11. Margin Over Current Estimate (MOCE):

Inclusion of paragraph 52a) is premature and NAIC supports inclusion of 100% of MOCE in capital resources (also note our comment 1b, above). We interpret paragraph 60 to mean that both GAAP and IFRS are producing more conservative reserves than a market adjusted approach. The level of relative conservatism between GAAP and IFRS is not clear. The NAIC supports further discussion of potential reasonable standards for inclusion of MOCE in capital resources, but only after the components of BCR requirements have been finalized and a reporting track record established. There are very few jurisdictions implementing a full MOCE at present (and potentially no G-SII jurisdictions), and it should be recognized that the provisions in ICP14 were predictive of what at that time was believed to be imminent global implementation of an accounting regime utilizing current estimates and MOCEs. The failure of the IASB and FASB to finalize (or converge) their insurance accounting – much of which is due to the complexity of calculating MOCEs – implies that care is required in the treatment of MOCEs.

A substantial part of MOCE, when based on regulatory requirements, can be considered as additional jurisdictional capital that is embedded in reserves rather than as explicit capital requirements. This is an important consideration when comparing BCR to the jurisdictional PCR.

In addition, MOCE is in part reflective of differences in valuation methods across jurisdictions. Those valuation differences are part of the overall solvency framework that yields a jurisdictional capital PCR. As we transition to the ICS discussion, NAIC supports recognition of how these differences contribute to an outcome that can be compared to the ICS framework (also see comment #12, below) rather than necessitating potentially costly and confusing changes to arrive at a single global valuation basis underlying a global capital standard.

**Section 5.1 Paragraph 57**

12. Paragraph 57 / Annexes C - Valuation:

The NAIC understands using the Market Adjusted Valuation Approach for expediency during the initial testing of the BCR. However, it remains extremely unclear as to whether this metric will in fact be widely utilized globally for insurance liabilities; at present, there are very few countries using it, and even after the implementation of Europe’s Solvency II, greater than 50% of the world market (by premium) is not currently scheduled to use it. Consequently, this qualified use of
the market adjusted approach should not be assumed to extend to the ICS, or indeed to any longer term implementation or expanded application of the BCR. (See related comments on Annex C below #15)

<table>
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<tr>
<th>Section 6.1 Paragraph 62 and 64</th>
<th>13. BCR / PCR Ratios:</th>
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<td>Annex F, Paragraph 13 includes the following goal for rough calibration of the BCR:</td>
<td></td>
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<tr>
<td>&quot;Calibration was then carried out consistent with the objective of targeting the BCR between the upper and lower thresholds for supervisory intervention (e.g. typically between PCR and MCR).&quot;</td>
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<td>This is reinforced in the opening to paragraph 62. Given that the goal was a BCR that is frequently below jurisdictional PCRs, it appears that the rough initial BCR fell exactly where it was targeted using an alpha of 1. In addition, the average BCR/PCR ratio is not indicative of the range of results and it is suggested that information on the range be provided after all initial refinements are made. Therefore, NAIC reiterates its support for maintaining the alpha at no more than 1 (also see our comment 1d, above regarding the alpha).</td>
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<tr>
<th>Section 6.2 Paragraph 67</th>
<th>14. Implementation of the BCR:</th>
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<tr>
<td>It seems unlikely that the BCR alone would require implementing since the NAIC does not view BCR as a capital standard on its own. It is only a standard for G-SIIs in combination with HLA. This paragraph will be more appropriate when the HLA Paper is issued. In any case, it is suggested that the word &quot;legislative&quot; be removed from the paragraph.</td>
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<tr>
<th>Annex C Paragraph 27</th>
<th>15. Annex C (Paragraph references relate to the Annex C contents):</th>
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<tbody>
<tr>
<td>Recommend adding &quot;Ideally,&quot; at the beginning of the sentence. While ideally one may suggest utilizing stochastic methods, the practicality of doing so is not clear even other than for initial reporting.</td>
<td></td>
</tr>
<tr>
<td>Paragraph 32</td>
<td>Suggest changing &quot;not purely financial self-interest&quot; to &quot;not in accordance with the efficient markets hypothesis&quot; (since this hypothesis is demonstrably not valid for protection products).</td>
</tr>
<tr>
<td>Paragraph 34</td>
<td>Recommend adding &quot;Ideally,&quot; at the beginning for the same reasons as for paragraph 27.</td>
</tr>
<tr>
<td>Paragraphs 44-54</td>
<td>For expediency for the initial field testing, the NAIC is prepared to accept the usage of IAIS prepared discount curves. However, the presumptions underlying these curves, especially any emphasis on risk free rates, are unlikely to be acceptable longer term, and will need revisiting.</td>
</tr>
</tbody>
</table>
August 4, 2014

Mr. Ryan Workman  
International Insurance Program Counsel  
International Insurance Relations (G) Committee  
National Association of Insurance Commissioners

Re: Comments on the IAIS Public Consultation Document on the Basic Capital Requirements for Global Systemically Important Insurers

On behalf of the American Academy of Actuaries’ Solvency Committee, I appreciate this opportunity to provide the attached comments on the International Association of Insurance Supervisors’ second public consultation document regarding the proposed Basic Capital Requirements for Global Systemically Important Insurers. The Academy will also be sending a copy of these comments to the International Actuarial Association.

If you have any questions or would like to discuss these comments further, please contact Lauren Sarper, the Academy’s senior policy analyst for risk management and financial reporting, at 202.223.8196 or sarper@actuary.org.

Sincerely,

Elizabeth K. Brill, MAAA, FSA  
Chairperson, Solvency Committee  
American Academy of Actuaries

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1 The American Academy of Actuaries is 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policy-makers on all levels by providing leadership, objective expertise and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice and professionalism standards for actuaries in the United States.
American Academy of Actuaries’ Solvency Committee
Comments on July 9, 2014 IAIS Consultation Draft on the Basic Capital Requirements for Global Systemically Important Insurers

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<th>Item</th>
<th>Paragraph Reference</th>
<th>Comment</th>
<th>Alternative Approach</th>
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<tbody>
<tr>
<td>1</td>
<td>General</td>
<td>The consultation draft indicates that a Market Adjusted Valuation Approach will be taken to develop the balance sheet. A market-based approach would not be appropriate for many insurance products—such as long term life and annuity products—and could have adverse consequences for insurers in many jurisdictions, including the U.S. Fundamentally, both market value and amortized cost approaches are well suited to certain products and environments, but not in others. For long-duration, illiquid insurance, a market value approach does not work. Evidence of this can be seen in the history of U.S. insurance accounting. Prior to the great depression, the U.S. used a market-based approach to valuing life insurance. However, during the Great Depression regulators decided market-based valuation requirements should not apply to insurers with illiquid liabilities, which allowed insurers to continue to invest in the economy and stabilize markets.</td>
<td>An approach that either allows long-duration, illiquid products to be valued on an amortized cost basis or an approach that does not rely on a balance sheet valuation is necessary for an effective capital requirement.</td>
</tr>
<tr>
<td>2</td>
<td>General</td>
<td>The draft does not reflect all major risk factors. There does not appear to be any charge for catastrophic risk.</td>
<td>Add a charge for catastrophic risk.</td>
</tr>
<tr>
<td>Item</td>
<td>Paragraph Reference</td>
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<tr>
<td>3</td>
<td>General</td>
<td>Field testing captures a point-in-time state. Volatility is not captured when examining a static state and can only be captured when examining several points in time, with particular need for stressed periods.</td>
<td>Field testing should look at multiple points in time and real stresses—such as the 2008 financial crisis—with regard to asset risk, several underwriting cycles with regard to property/casualty pricing risk, and years with large natural disasters—like Hurricane Sandy in 2012—with regard to catastrophe risk.</td>
</tr>
<tr>
<td>4</td>
<td>1.1, par 2</td>
<td>The development of the international capital standards (ICS) will be informed by the work on the basic capital requirements (BCR). The initial approach for BCR does not pre-empt future development of alternative approaches to discounting.</td>
<td>In connection with the ICS, the International Association of Insurance Supervisors (IAIS) should evaluate methods of assessing capital adequacy that do not rely on a balance sheet valuation. There are two approaches that have been discussed—using internal models and leveraging local requirements. Stress testing is a prime example of an approach that uses internal models rather than relying on a balance sheet valuation. Such an approach can be constructed in a way that does not require a single international valuation basis, yet allows the regulator to understand under what circumstances each group might come under stress and potentially be unable to meet its obligations. We suspect that some combination of local requirements and models using internal risk exposure data will be required to sufficiently reflect local differences in risk.</td>
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<td></td>
<td>Annex C, par 44</td>
<td>The consultation document clearly states that the development of the ICS will be informed by the BCR and implies (via the reference in Annex C to alternative discounting approaches) that future work also will use a current estimate approach. The current estimate/factor-based approach to the BCR should not form the basis of the ICS. For the reasons described in Item 1 above, the current factor-based approach is not effective and does not appropriately reflect local differences. In addition, the focus on Global Systemically Important Insurers (G-SIIs) has not allowed for sufficient investigation of risks in areas other than life insurance, including health and property and casualty (P&amp;C). Such risks generally are not a concern for the G-SIIs, which are the focus of the BCR.</td>
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The consultation document clearly states that the development of the ICS will be informed by the BCR and implies (via the reference in Annex C to alternative discounting approaches) that future work also will use a current estimate approach. The current estimate/factor-based approach to the BCR should not form the basis of the ICS. For the reasons described in Item 1 above, the current factor-based approach is not effective and does not appropriately reflect local differences. In addition, the focus on Global Systemically Important Insurers (G-SIIs) has not allowed for sufficient investigation of risks in areas other than life insurance, including health and property and casualty (P&C). Such risks generally are not a concern for the G-SIIs, which are the focus of the BCR.
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<tr>
<td>5</td>
<td>2.2.2, par 20</td>
<td>The calculation of current estimates requires taking the present value of all relevant future cash flows. Since cash flows must be calculated anyway, we question why it is necessary to then overlay an accounting basis in determining the BCR.</td>
<td>Take a more streamlined, straightforward, and comparable approach by stress testing the cash flows directly rather than creating a market-adjusted balance sheet and then stress testing. (Note that simpler approaches may be sufficient for shorter tail lines for which the timing of the flows has less of an economic impact. In such cases, stress testing the nominal amounts may be sufficient.)</td>
</tr>
<tr>
<td>6</td>
<td>2.2.4, par 24</td>
<td>The calibration level of the BCR will account implicitly for some degree of diversification. This implicit reflection of diversification by adjusting the factors creates an unlevel playing field. It reduces the otherwise calculated factors for all companies rather than directing the credit to those that achieved the diversification. Hence, those companies with no or less diversification gain a benefit at the expense of those with higher levels of diversification.</td>
<td>If the desire is to keep the overall formula simple, then use a simple formulaic way of reflecting diversification, such as through a simple square root of the sum of the squares covariance formula.</td>
</tr>
<tr>
<td>7</td>
<td>2.2.5, par 25</td>
<td>The calibration level of the BCR will account implicitly for the absence of an assets and liability management (ALM) factor. Similar to the diversification argument for paragraph 24, this implicit approach creates an unlevel playing field by reducing the charge for those with ALM risk and overstating the charge for those without this risk.</td>
<td>Investigate simple ways to reflect ALM risk, at a minimum, in order to create appropriate incentives.</td>
</tr>
<tr>
<td>8</td>
<td>3.4, par 36</td>
<td>BCR segment: “Annuities” Are these deferred or income-paying? Deferred and income-paying annuities have entirely different risk profiles.</td>
<td>Add clarification.</td>
</tr>
<tr>
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<tr>
<td>9</td>
<td>3.4, par 36</td>
<td>Proxy measure for risk exposure: current estimate for non-life non-property</td>
<td>It is not clear if this is meant to be a value net or gross of reinsurance. Subsequent discussion of “current estimate” versus reinsurance recoverable implies that “current estimate” is gross of reinsurance, yet the charges in the same paragraph for reinsurance recoverables imply low collection risk, and the proxy for property risk is a value net of reinsurance.</td>
</tr>
<tr>
<td>10</td>
<td>3.4, par 36</td>
<td>The risk factor applied to “other non-traditional” current estimates is 1.29 percent. This compares to the lowest risk factor applied to traditional non-life current estimates of 6.25 percent.</td>
<td>The use of a lower risk factor for “other non-traditional” P&amp;C lines than for “traditional” P&amp;C lines implies that non-traditional risks are not a risk issue for the BCR. Additionally, this creates an incentive to call everything “non-traditional” for a P&amp;C company.</td>
</tr>
<tr>
<td>11</td>
<td>4, par 46</td>
<td>Capital resources are determined on a consolidated basis.</td>
<td>There is no discussion regarding transferring needed capital across jurisdictions.</td>
</tr>
<tr>
<td>12</td>
<td>5.1, par 60</td>
<td>Key difference between the International Financial Reporting Standards (IFRS) and the Generally Accepted Accounting Principles (GAAP) is margin over current estimate (MOCE).</td>
<td>This statement ignores that the differences in discount rates are significant for U.S. GAAP reporters.</td>
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<tr>
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<tr>
<td>13</td>
<td>Annex C</td>
<td>Length and prescriptive level of the guidance. The length and prescriptive nature of this Annex appears to create both a separate accounting standard and new actuarial guidance. We have significant concerns with creating a new accounting standard and creating such detailed actuarial guidance in a “principle-based” framework. In particular, the extent to which this would be applied (given the low number and geographic spread of G-SIIs) is unlikely to result in a level of “generally acceptable” and common practice in application.</td>
<td>It is better to leverage existing accounting frameworks or use an approach that does not rely on a balance sheet valuation, and provide the general objectives for the actuarial estimates, rather than providing prescriptive statements on estimation methodology.</td>
</tr>
<tr>
<td>14</td>
<td>Annex C, par 25</td>
<td>Discounting... occurs with a yield curve relevant to the particular currency. Both Greece and Germany use the same currency, but it does not make sense that they would use the same discount rates.</td>
<td>Add “and jurisdiction” to the sentence in question.</td>
</tr>
<tr>
<td>15</td>
<td>Annex C, par 49</td>
<td>Only 40 percent of the actual corporate bond spread is used for the adjustment. This seems like it is adding a MOCE to the current estimate. If the investments are at market, they will already reflect credit-worthiness.</td>
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NAIC Proceedings – Summer 2014

International Insurance Relations (G) Committee 8/16/14
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<tr>
<td>16</td>
<td>Annex D, par 3</td>
<td>Financial instruments will be classified as Core Capital only if they do not have a fixed maturity and have distributions that can be cancelled.</td>
<td>Will surplus notes be classified as Core Capital pursuant to Annex D, par 6? Will senior debt held at the insurance holding company be classified as Core Capital, if cash cannot be upstreamed from the operating company to the holding company to pay such debt without supervisory approval? Specify that surplus notes (as well as debt at the holding company level) will be classified as Core Capital whenever regulatory approval is required to remove funds from insurance entities to pay such debt in a distressed situation.</td>
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<tr>
<td></td>
<td></td>
<td>Core Capital includes surplus funds and contributed surplus.</td>
<td>We believe that surplus notes (and proceeds from holding company debt contributed to the operating insurer) are categorized appropriately as surplus under the U.S. statutory accounting framework and believe they should be similarly classified as Core Capital for purposes of the BCR (and under ComFrame generally).</td>
</tr>
<tr>
<td>17</td>
<td>Annex F, par 26</td>
<td>Net Amount at Risk (NAAR) is equal to sum of the insured minus current estimate, net of reinsurance recoverables.</td>
<td>All the current estimates are gross of reinsurance (page 25, par 10). Reinsurance recoverables are calculated and recognized separately. So, the preparer will have to pull out any protection reinsurance recoverables from this calculation. That may not be easily done. Have NAAR be gross of reinsurance.</td>
</tr>
</tbody>
</table>
The International Insurance Relations (G) Committee met via conference call July 24, 2014. The following Committee members participated: Kevin M. McCarty, Vice Chair (FL); John M. Huff represented by John Rehagen (MO); Bruce R. Ramge (NE); Kenneth E. Kobylowski (NJ); and Benjamin M. Lawsky represented by Martha Lees (NY).

1. **Discussed Draft NAIC Comments on IAIS Draft Application Paper on Supervisory Colleges**

   Commissioner McCarty noted that he would chair the meeting in the place of Commissioner Michael F. Consedine (PA), and he introduced the International Association of Insurance Supervisors (IAIS) draft Application Paper on Supervisory Colleges. He mentioned that the paper recognizes that insurance supervisors have different perspectives on and roles within supervisory colleges. He said that an effective college acknowledges these differences and tries to achieve the optimal form of cooperation considering the different perspectives. Commissioner McCarty stated that this will help supervisors learn from each other by explaining relevant experiences in and with colleges and presents good practices and examples that will help promote a common understanding for participants of supervisory colleges. Commissioner McCarty commented that the Group Solvency Issues (E) Working Group and NAIC staff reviewed the paper and provided draft comments (Attachment Two-A). He expressed a general comfort with the paper, which will be helpful to supervisors in the college context as it recognizes different approaches can result in similar outcomes. These draft comments were sent to Committee members and interested parties the previous week, but no additional comments were received.

   Ryan Workman (NAIC) stated the NAIC comments provide general support for the paper and include some specific editorial suggestions, in particular on the use of terms and descriptions in the paper to ensure they are accurate and reflect what is intended.

   Director Ramge suggested that the paper should emphasize the importance of receiving regulator feedback after each supervisory college meeting, which can then help improve relevant processes. Commissioner McCarty agreed and suggested this be added to the comments.

   Having no quorum, Commissioner McCarty noted that the revised comments would be circulated to Committee members for consideration of approval via e-vote so that the comments may be submitted to the IAIS by its July 25 deadline (Attachment Two-B).

2. **Discussed Other Matters**

   Commissioner McCarty noted that the Committee will meet Aug. 7 to discuss and review comments on four other IAIS draft papers out for consultation.

   Additionally, Commissioner McCarty commented that there would be an International Capital Standards Forum at the Summer National Meeting to discuss the development of international capital standards in an open dialogue amongst regulators and interested parties.

   Having no further business, the International Insurance Relations (G) Committee adjourned.
<table>
<thead>
<tr>
<th>Section/Paragraph</th>
<th>Comment</th>
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<tbody>
<tr>
<td>General</td>
<td>The general thoughts and examples presented in the paper are relevant and beneficial to supervisors and particularly helpful in illustrating how there can be common expectations for supervisory colleges but different perspectives and approaches which can be equally effective. There are some consistency and minor editorial changes throughout the paper that should be made as part of the final review process (see typos in paragraph 20 for example) and capitalization issues. Additionally, suggest reviewing that the terms in the definition sections are used in the document as defined and that the references to the ICPs and the ComFrame draft specifications are up-to-date.</td>
</tr>
<tr>
<td>Section 1</td>
<td>This section is very well done, putting supervisory colleges, as well as the application guidance into perspective. Particularly helpful is paragraph 7 which recognizes that best practices will evolve, and that is part of why the applicable guidance as pointed out in paragraph 1 should not be construed as providing formal guidance or expectations.</td>
</tr>
<tr>
<td>Paragraph 2</td>
<td>There is a reference to MMoUs but this should be changed to MoUs as this is referring to Memoranda of Understanding and not Multilateral Memorandum of Understanding.</td>
</tr>
<tr>
<td>Paragraph 5</td>
<td>Suggest changing the following sentence from “In reality many of college participants – but rarely all of them - are also signatories to the IAIS MMoU for information Exchange” to “but rarely all of them presently&quot;</td>
</tr>
<tr>
<td>Paragraph 12</td>
<td>Change “the creation of any additional burden” to “the creation of any unnecessary additional burden”</td>
</tr>
<tr>
<td>Section 2 Terms and Descriptions</td>
<td>Under the explanation of “College participant” suggest adding: “College participants may sign the coordination agreement/cooperation arrangement as deemed appropriate”. Under the explanation of “Coordination agreement/cooperation agreement” replace “Like a MoU/MMoU, it is legally non-binding” with “Generally it is legally non-binding in the sense that it does not create enforceable obligations from one supervisor to another”</td>
</tr>
<tr>
<td>Paragraph 45</td>
<td>In light of the Introduction section language, it would be more appropriate for this first sentence to not be so prescriptive – suggest changing, “…the GWS will need to participate in every membership structure of the group…” to “…the GWS may want to participate in every membership structure of the group…”</td>
</tr>
<tr>
<td>Paragraph 48</td>
<td>Suggest adding the words “or volunteers” to the first sentence to read: “if a college member, as host supervisor is tasked, or volunteers, to organize…”</td>
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<tr>
<td>Section/Paragraph</td>
<td>Comment</td>
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<tr>
<td>Paragraphs 113 and 114</td>
<td>We have some concern with this section because even as examples, it may establish a perceived standard that may be counterproductive to the college since it may overemphasize solo entity information and may suggest all of these items should be provided, which could divert attention away from group information. It may be appropriate if a specific solo entity is the primary source of risk, but we have some concern this could be misinterpreted without some additional language to provide better context. Suggest adding a new introductory sentence under this section before paragraph 113 to avoid such confusion: “Risk can come from various aspect of the organization and therefore it may be helpful to share quantitative and/or qualitative data which may be helpful in pinpointing the risks of the group.” Additionally, paragraphs 113 and 114 should be amended to reinforce that these are examples and read respectively: “113. Quantitative data may include one or more of the following:” and “114. Qualitative data may include one or more of the following:”</td>
</tr>
<tr>
<td>Paragraph 133</td>
<td>Suggest adding to the end of this paragraph, “Following face-to-face college meetings, supervisors should consider asking participants to complete an evaluation/feedback sheet. This would allow focus on what particular needs each college member expects to take away from the meetings and facilitate improvements to the college process.”</td>
</tr>
<tr>
<td>Paragraph 168</td>
<td>As not all readers may be familiar with Takaful, it may be helpful to provide a very brief footnote explanation or definition.</td>
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</table>
The International Insurance Relations (G) Committee conducted an e-vote that concluded July 25, 2014. The following Committee members participated: Michael F. Consedine, Chair (PA); Kevin M. McCarty, Vice Chair (FL); Thomas B. Leonardi, Immediate Past Chair (CT); Karen Weldin Stewart (DE); James J. Donelon (LA); Joseph G. Murphy (MA); John M. Huff (MO); Bruce R. Ramge (NE); Kenneth E. Kobylowski (NJ); Benjamin M. Lawsky (NY); Julia Rathgeber (TX); and Susan L. Donegan (VT).

1. **Adopted NAIC Comments on IAIS Draft Application Paper on Supervisory Colleges**

The Committee conducted an e-vote to approve submission of NAIC comments to the International Association of Insurance Supervisors’ on its draft application paper on supervisory colleges (Attachment Two-A). A majority of the Committee members voted to approve submission of the comments. The motion passed.

Having no further business, the International Insurance Relations (G) Committee adjourned.
The International Insurance Relations (G) Committee met via conference call April 23, 2014. The following Committee members participated: Michael F. Consedine, Chair (PA); Kevin M. McCarty, Vice Chair (FL); Joseph G. Murphy (MA); John M. Huff represented by John Rehagen (MO); Bruce R. Range (NE); Kenneth E. Kobylowski (NJ); Benjamin M. Lawsky represented by Michael Sheiowitz (NY); Julia Rathgeber represented by Danny Saenz (TX); and Susan L. Donegan (VT).

1. Adopted NAIC Comments on the IAIS Draft Issues Paper on Approaches to Group Corporate Governance – Impact on Control Functions

Commissioner Donegan reported that the International Association of Insurance Supervisors (IAIS) released its draft Issues Paper on Approaches to Group Corporate Governance – Impact on Control Functions for consultation on March 21. The paper was drafted by the IAIS Governance and Compliance Subcommittee (GCS) with the purpose of providing insights into the implications that arise for insurance groups and their approaches to governance, including in the context of the IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). She said the paper illustrates that there is not a “one-size-fits-all” approach to group-wide corporate governance and that insurers within groups may perform corporate governance differently, depending on how the group is structured, along a continuum of centralized versus decentralized approaches.

Commissioner Donegan stated that the paper is intended to be useful to the IAIS as it continues work on ComFrame and informative for supervisors when reviewing insurance groups in their jurisdiction. Additionally, it is intended to create awareness and illustrate practices for good governance to insurance groups on issues they need to consider and address when setting up and assessing the effectiveness of the corporate governance framework of their group.

Commissioner Donegan noted that, per the usual process, members of the relevant NAIC working group, in this case the Corporate Governance (E) Working Group, and NAIC staff reviewed and provided draft comments (Attachment Three-A), which were sent to the Committee members and interested parties. She stated that one Committee member sent a comment supporting the draft NAIC comments, but no other comments were received.

Commissioner Donegan explained that while a number of the comments on the paper were editorial in nature, the NAIC had some general and a few more specific comments about the tone of the paper, which sometimes suggests a level of prescriptiveness that should not be used in an IAIS issues paper. She noted that this was not the intent of the GCS and instead likely a result of drafting style and word choice that should be resolvable as the paper is finalized.

Commissioner Consedine asked whether the IAIS issues paper provides help and whether it relates to the current work at the state level on supervisory aspects of corporate governance. Commissioner Donegan responded that both recognize the need to not be overly prescriptive and that supervisors need certain information in order to better understand the corporate governance of insurers, but it is not the role of supervisors to tell companies how to run and organize their business because there is no one-size-fits-all approach.

Commissioner Murphy made a motion, seconded by Commissioner Kobylowski, to submit the NAIC comments to the IAIS on its draft issues paper. The motion passed.

2. Discussed Other Matters

Commissioner Consedine noted that there are a number of other international activities, with updates to be provided at future Committee meetings. He said the issues of mutual recognition and equivalence would be discussed at upcoming U.S./European Union (EU) events in Washington, DC. He also noted that the NAIC International Insurance Forum would take place May 13–14 in Washington, DC, and would feature panels and speakers on a variety of topics.

Having no further business, the International Insurance Relations (G) Committee adjourned.
**General comments**

The general thoughts and issues presented in the paper are relevant and beneficial to insurers and supervisors and particularly helpful in illustrating how a one-size-fits-all approach does not work within ComFrame.

In some parts of the paper, there is a tone of definitiveness or certainty (for example: to ensure x do y; to achieve x do y) which in some cases runs contrary to the purposes of the paper to highlight issues and illustrate different approaches. As the paper contains a number of group governance challenges and subsequent practices, it is important that these are seen as suggestive or as examples; otherwise one could come away with the impression that these are the only challenges and the only solutions. As the paper was not written with this intent, this is mostly a drafting style issue that could be resolved in the final editorial revision of the paper.

Additionally, there are some consistency and minor editorial changes that should be made as part of finalizing the paper.

**Section 1.1, paragraph 3c**

The practices provided in the paper may be insightful to insurers and supervisors but they cannot ensure that good governance is achieved through following them. Instead, the objectives of highlighting certain practices should be to provide suggestions and thoughts regarding how certain risks associated with various governance structures might be reduced. The use of “ensure” throughout the paper should be checked so that appropriate expectations are being set.

**Section 1.2, paragraph 7**

As the explanation of the centralized approach and the decentralized approach are key to this paper, suggest these be set off in separate bullets so they have more prominence. Additionally, some of the material in this paragraph is repeated in paragraphs 36 and 39. To avoid duplication, suggest deleting paragraphs 36 and 39 but move the non-repetitive text in those paragraphs to the relevant parts of paragraph 7.

**Section 3.1, general**

As this section highlights relevant material from the ICPs, the presentation of ICP material should be done in a consistent manner – such as providing direct quotes and/or high-level summaries with relevant footnotes citing the origin. Otherwise, paraphrasing could unintentionally lead to misinterpretation. Proper citations inform the reader as to whether the ICP material being mentioned is at the principle, standard or guidance level, which makes a difference.

**Section 3.1, paragraphs 19 and 20**

Suggest deleting these paragraphs. ICP 23 is currently under review and it is unclear whether the ICP 23 material referenced in paragraph 19 will be included in the revised version; additionally the last sentence repeats what is in paragraph 18 and elsewhere. The material on ICP 25 in paragraph 20 is not specific to group governance and the need for supervisory cooperation as required by ICP 25 is mentioned later in paragraph 71.

**Section 4.1, general**

While this section appears generally consistent with ICP 7, the expected roles and responsibilities of the Board may seem overly aspirational, whereas the expected roles and responsibilities of Senior Management may seem overly simplified. For example, while U.S. state insurance supervisors typically expect the Board to review and approve the overall strategy of the organization, strategy formulation and development is typically the responsibility of the CEO and other members of Senior Management. Therefore, expectations limiting Senior Management’s role to day-to-day management with no responsibilities for strategic planning and vision may be somewhat misleading. Therefore, we suggest that this section and the diagram be modified to reflect a more practical expectation regarding the roles of the Board and Senior Management.
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<tr>
<td>Section 4.2, paragraphs 30 and 31</td>
<td>Some of the material in these paragraphs repeats what was already stated in paragraph 6. Suggest combining these two paragraphs but delete the last sentence in the latter.</td>
</tr>
<tr>
<td>Section 4.3, paragraph 23</td>
<td>Suggest making the list of key characteristics more consistent with how they are described later in the paper in subsections of Section 5 and paragraph 76. In the former, risk management and compliance are listed separately (f and g) and in the latter these have been combined. Additionally, the last key characteristic on control functions includes compliance so it somewhat confusing to have compliance as separate if the two paragraphs were combined.</td>
</tr>
<tr>
<td>Section 4.4, general</td>
<td>While the various examples/models presented in this section are illustrative; the governance information each example contains varies, which may limit the ultimate value they provide. Also, where the risk management and compliance controls are not under the same paternal authority, the group description of the overall risk management function is somewhat confusing. This highlights how the difference between the control approaches may be discussed for each model.</td>
</tr>
<tr>
<td>Example 1</td>
<td>Example 1 states that there is no group-wide underwriting policy, as the diversity of products the group offers makes such a policy impractical. However, designing “underwriting policies” as set by businesses is not the same thing. While the NAIC appears to be required under M2E4-4 in the current draft of ComFrame, it is an example of a situation where an “underwriting policy” appears to be required under M2E4-4 in the current draft of ComFrame. Is this example a situation whereby the “group-wide underwriting policy” is that the individual business units within the group set their own underwriting policies? If so, then this text in this example should be revised accordingly. Otherwise, this suggests that what may qualify as a group-wide policy under ComFrame is much more prescriptive, which is contrary to the findings of this Issues paper.</td>
</tr>
<tr>
<td>Section 5 – general</td>
<td>Various paragraphs within Section 5 suggest practices to address the challenges likely to arise in establishing a more centralized or decentralized approach to corporate governance. While a number of the suggested practices appear helpful to insurers and supervisors, other practices appear to be more prescriptive in nature and potentially limited in their applicability to various organizations. Therefore, it should be clear that these are suggestions and just a few of the possible solutions to the various approaches to governance IAIGs may take and the resulting challenges. Secondly, the paper makes it clear that regardless of whether a group follows a more centralized or more decentralized approach to corporate governance, there will be challenges in effectively overseeing its operations and solvency position. However, some parts of this section seem to oversimplify issues by recommending that groups following a centralized governance approach incorporate certain decentralized practices and vice-versa. Additionally, some of the suggested practices identified may be helpful regardless of which approach is taken. Thus a review of the suggested practices may help improve this section.</td>
</tr>
<tr>
<td>Section 6, paragraph 71</td>
<td>Suggest deleting a) and b) as the material contained therein is not group-governance specific, nor necessary to make the point of the overall paragraph.</td>
</tr>
</tbody>
</table>
The ComFrame Development and Analysis (G) Working Group of the International Insurance Relations (G) Committee met in Louisville, KY, Aug. 16, 2014. The following Working Group members participated: Kevin M. McCarty, Chair (FL); John Loughran (CT); Cindy Donovan (IN); John Turchi (MA); John Rehagen (MO); Bruce R. Ramge (NE); Kenneth E. Kobylowski (NJ); Benjamin M. Lawsky (NY); Steve Johnson (PA); Julie Mix McPeak (TN); Doug Slape (TX); and David Smith (VA). Also participating was: Susan Donegan (VT).

1. **Adopted its June 5 Minutes**

Commissioner Kobylowski made a motion, seconded by Commissioner McPeak, to adopt the Working Group’s June 5 minutes (Attachment Four-A). The motion passed.

The ComFrame Development and Analysis (G) Working met in regulator-to-regulator session July 23, June 26, June 10 and May 19 pursuant to paragraph 8 (consideration of strategic planning issues relating to federal legislative and regulatory matters or international regulatory matters) of the NAIC Policy Statement on Open Meetings.

2. **Heard an Update on the Field Testing Process of the IAIS ComFrame**

Ramon Calderon (NAIC) said the International Association of Insurance Supervisors’ (IAIS) Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) document was finalized earlier this year and is now subject to field testing over a period of three years. He commented that Module 1 of ComFrame was field tested earlier in the year, which included a review of the criteria for defining an IAIS and a survey of member jurisdictions’ authority over holding companies. Most recently, field testing has focused on quantitative testing of 33 volunteers, which includes the submission of a quantitative questionnaire and a related data template, largely to assist in the development of a basic capital requirements (BCR) for global systemically important insurers (G-SIIs) and to understand the impact of capital resources based on the definitions in ComFrame. He added the quantitative testing will continue over the three-year field testing period and that the next data submission will include an evaluation of how simple stresses affect the balance sheet under specified valuation bases. Mr. Calderon stated that as the development of the IAIS global insurance capital standard (ICS) begins, the next iteration of quantitative testing will be tailored to obtain information to support the development of the ICS. He added that field testing also includes qualitative aspects, with testing of those aspects of Module 2 beginning in October, and that testing of the supervisory processes in Module 3 will begin in 2015.

Commissioner McCarty asked whether field testing of Module 2 had resulted in any changes as to how capital resources are currently defined in ComFrame. Mr. Calderon replied that initial field testing results do not indicate any adverse findings related to the definitions of capital resources but that further analysis continues by the IAIS Field Testing Task Force.

3. **Discussed IAIS Capital Developments**

Commissioner McCarty noted that in addition to ComFrame, the IAIS is also working on development of global group-wide capital standards on two separate but related fronts: 1) the BCR and higher loss absorbency (HLA) for G-SIIs; and 2) the ICS for all internationally active insurance groups.

Commissioner Kobylowski reported that the BCR is the main priority of the IAIS at the moment and that several NAIC staff members are directly involved in this work, which is expected to deliver a comparable base capital upon which to add HLA capital requirements for G-SIIs. On July 9, the IAIS released its second consultation document on BCR, which sought input on a specific proposal to facilitate the final design and calibration of the BCR and a proposal that BCR required capital will be calculated on a consolidated group-wide basis, with all holding companies, insurance legal entities, banking legal entities and any other service companies included in the consolidation. The proposal is for the BCR to be constructed in three basic
components: 1) an insurance component; 2) a banking component; and 3) a component for other non-insurance, non-banking activities not currently subject to regulatory capital requirements. The initial factors and general level of the BCR for the insurance component were established using data provided by 33 volunteers from various jurisdictions, including eight from the U.S., and through use of supervisory judgment.

Commissioner Kobylowski said members of the Working Group and NAIC staff developed comments on this consultation paper, which were discussed and approved for submission by the International Insurance Relations (G) Committee. The proposed BCR, with any modifications made as a result of comments received during the consultation process, is expected to be approved by the IAIS and go to the Financial Stability Board (FSB) this fall for its review before going to G20 Leaders Summit for endorsement in November. He noted that it is expected that data coverage and quality will be improved over time, and the BCR will be refined over the next few years. In addition, given the potential for future refinement, one of the NAIC comments in the consultation highlighted that if initial revisions result in materially different results than those portrayed in the consultation paper, it may be necessary for the IAIS to have another round of consultation.

Commissioner Kobylowski said the BCR is a capital standard only in combination with HLA and that the combined BCR + HLA is scheduled to start applying to G-SIIs in 2019. He noted initial drafting discussions have begun on the HLA, and a preliminary consultation paper is expected to be released in December 2014, with a final HLA proposal expected in the fall of 2015. Discussion so far at the IAIS has centered on whether HLA uplift will be broad-based on the entire BCR or focused on nontraditional, non-insurance activities measured in the BCR that generate systemic risk. He added it is yet to be determined whether the IAIS will target an overall calibration level for the combined BCR + HLA or have separate targets for each component. The suggestion that the BCR will be refined over time while a final proposal on HLA will be completed next year leaves open some questions of timing and coordination of these two elements. He said HLA also continues to be a topic of discussion in terms of how it will transition from using the BCR as its base to using the ICS as its base.

Commissioner McPeak reported that the IAIS has started developing initial thoughts on the ICS earlier this year, with the IAIS holding an observer hearing on the ICS at its June meetings in Québec. She noted the ICS is on a tight timeline, with testing of the proposed ICS construct scheduled from 2015 to 2016 and the development of the ICS to be completed by the end of 2016. The IAIS is drafting an initial public ICS consultation document to be released by the end of 2014. She added that following further testing and refinement, a final ICS is expected by the end of 2018, and implementation of ComFrame, which includes the ICS, by the various IAIS members is expected to start thereafter.

Commissioner McCarty commented that the NAIC had held an International Capital Standards Forum the previous day, with the purpose of having an interactive discussion on the development of an ICS, focusing on three main topics: 1) the goals and the benefits, costs and consequences of an ICS; 2) the realities of developing a global ICS, including the hurdles that need addressing in order to develop a global ICS and whether these can be overcome; and 3) approaches for developing a global ICS, looking at feasible and practical versions of a global ICS that would complement the national system of state-based insurance regulation in the U.S. He noted there were more than 200 attendees, including state insurance regulators, federal colleagues, state legislators, consumer representatives and industry representatives.

Commissioner McCarty said the forum was just the beginning of these important discussions and summarized the comments and issues raised, including: 1) there is a need for greater clarity on the objectives of a global ICS; 2) views on resolution and fungibility of capital will be important in considering where group capital should be located; 3) valuation is a key consideration, and forcing one approach over another could affect the ability to offer certain products and contribute to systemic risk; 4) the use of internal models has its place, but a one-size-fits-all approach would not allow insurers to reflect their own unique risks; 5) an ICS is just part of a capital adequacy assessment tool that could be particularly helpful in the supervisory college context; 6) U.S. regulators and interested parties need to look at potential approaches for developing a group capital standard that is appropriate for the U.S. market and regulatory system.

Steve Broadie (Property Casualty Insurers Association of America—PCI) asked how revisions to ComFrame would be handled as field testing and the development of the ICS moves forward and whether there would be the same level of transparency as was provided in the document development phase. Mr. Calderon explained that there would be draft revisions made to ComFrame as a result of the field testing process, but two additional consultations were already planned before the final draft would be adopted in 2018. Thus, there would be opportunity for interested party review and input.
Wally Givler (Northwestern Mutual) commented that during the International Capital Standards Forum, several different suggested approaches were referenced, and he asked what the next steps would be in moving proposals forward. Commissioner McCarty responded that the process had begun to assess where this project would fit within the NAIC structure and what the related charge would be. He added that the NAIC needs to move quickly on this project and asked interested parties to submit any proposals to NAIC staff for review.

Michelle Rogers (National Association of Mutual Insurance Companies—NAMIC) noted concerns on proposed changes to the IAIS policies and procedures on stakeholder input, which would affect interested parties’ abilities to follow and contribute to these developments. She also questioned whether the timing of the development of the ICS was appropriate given the challenges it presents. Commissioner McCarty noted that the IAIS stakeholder procedures would be discussed at the International Insurance Relations (G) Committee and that the IAIS had committed to a deadline on the ICS.

Having no further business, the ComFrame Development and Analysis (G) Working Group adjourned.
ComFrame Development and Analysis (G) Working Group  
Conference Call  
June 5, 2014

The ComFrame Development and Analysis (G) Working Group of the International Insurance Relations (G) Committee met via conference call June 5, 2014. The following Working Group members participated: Kevin M. McCarty, Chair (FL); John Loughran (CT); Pam Walters (IN); John Turchi (MA); John Rehagen (MO); Christy Neighbors (NE); Kenneth E. Kobylowski (NJ); Michael Sheiowitz (NY); Teresa Saldana (TX); and David Smith (VA).

1. Discussed the IAIS Memorandum to Observers on Global Insurance Capital Standard

Commissioner McCarty said the purpose of the call was to discuss and hear comments from interested parties on the development of the International Association of Insurance Supervisors’ (IAIS) global international capital standard (ICS), in particular focusing on the memorandum to IAIS observers that will be the basis for a hearing at the IAIS meeting later in June. He noted that the memo was a prelude to further IAIS discussions that will culminate in a full consultation paper that is expected to be released in December.

Commissioner McCarty said the overall approach to developing and implementing the ICS currently includes group scope, underlying financial data and the components of an ICS ratio, and it will be part of the IAIS Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame). In the discussions at the IAIS, the NAIC has favored an approach that has minimum impact on current group-wide financial reporting for internationally active insurance groups (IAIGs) and has supported narrowing the scope of the group from the full consolidated level used for the basic capital requirements (BCR) to as low as the insurance holding company level for the ICS. He noted that continued support for maximum use of supervisory colleges has also been expressed.

Steve Broadie (Property Casualty Insurers Association of America—PCI) expressed several concerns on the overall approach such as how qualified capital resources are being defined, including subordinated debt, and that definitions are not clear, the aims seem contradictory and more focus should be on policyholder protection.

Jeff Alton (CNA Financial) commented that the memo raises several questions and suggested that a benchmark would be helpful for jurisdictions that need to develop a group-wide capital assessment. He questioned whether the U.S. could develop such a group-wide assessment while maintaining existing supervisory structures.

Pooja Rahman (New York Life) commented that with the overall approach to an ICS, valuation and the lack of fungibility of capital are still issues that need to be addressed.

Michelle Rogers (National Association of Mutual Insurance Companies—NAMIC) asked whether the ICS is intended to be a baseline standard, and, if so, the IAIS should be looking at it as a minimum capital requirement (MCR), not a prescribed capital requirement (PCR). She questioned whether the ICS was intended to be on top of existing jurisdictional capital requirements or intended to be part of them.

Commissioner McCarty said the memo generally describes the aims of the ICS by itself, which include establishment of a globally comparable risk-based measure of capital adequacy, support of financial stability and policyholder protection, and replacing the BCR as a base for higher loss absorbency (HLA).

Mr. Broadie commented that the stated aims are laudable but questioned whether they were practical, noting that the overriding aim of policyholder protection seems to get lost.

Mr. Alton questioned the need for a separate balance sheet and suggested that the IAIS should start with consolidated balance sheets to develop the ICS.

Ralph Blanchard (Travelers Companies) commented that valuation has not been an issue for the property/casualty industry worldwide and that one valuation approach for one product does not work for all insurance products; thus, the ICS should not use a broad brush approach to valuation.
Commissioner McCarty said the memo relates to the issue of balance sheet valuation for the exposure proxies that will be used to establish the ICS requirement and the capital resources that will be used to meet the requirement. He added that the NAIC has not supported a single accounting or valuation basis that disproportionately requires U.S. groups to maintain an additional set of books besides the company-based statutory accounting principles (SAP) valuations and group-based U.S. generally accepted accounting principles (GAAP).

Mr. Alton raised concerns about the treatment of senior debt due to the amount held by the typical U.S. stock company and of deferred taxes, which may make up a large portion of a company’s balance sheet.

Commissioner McCarty said the memo addresses qualifying capital resources and the tiering approach taken in ComFrame. He noted that a core capital component of 50% appears reasonable in line with the definitions the IAIS Solvency Subcommittee developed as part of ComFrame; however, the importance of core capital in displaying a ratio that applies to systemically important groups, along with how that ratio would evolve when HLA is added to the equation, are topics of current discussion at the HLA Drafting Group.

Mr. Broadie commented that the tiering approach is a banking concept that did not necessarily make sense or seem appropriate for an ICS.

Commissioner McCarty said there are several questions in the memo relating to the issue of whether full or partial group internal models should be allowed in the ICS calculation. There is concern that use of group-specific internal capital models can actually work against comparability across jurisdictions, which would be contrary to the ICS’ main objective. He noted that the NAIC believes that discussion of internal models at this juncture is an unnecessary distraction to the other tasks of developing the BCR and HLA, and that the NAIC would generally favor concentrating on a standard approach before any discussion of potential use of internal models.

Mr. Broadie saw the use of partial models but had concerns about using full models; in order to reach the goal of comparability, models would have to be dictated to insurers, which would not be appropriate.

Mr. Blanchard commented that is was important to distinguish between the use of internal models versus external models, which are used for catastrophe risk. Joseph Sieverling (Reinsurance Association of America—RAA) added that, for reinsurers, there are several risks for which there are no third-party models, so reinsurers cannot rely only on such third-party models.

Commissioner McCarty said the memo sets out a brief rationale for two target criteria that will be tested for the ICS. From the NAIC perspective, it is not clear that any single target criteria will produce rational capital requirements across jurisdictions and that it does not recognize other compensating features such as those used within the U.S. insurance solvency framework. He added that the memo addresses the calibration of the PCR, which is the level above which no regulatory action is required, similar to the company action level and trend test in the RBC formula.

Mr. Alton noted that, while it could make sense for the ICS to be linked to a PCR, there needs to be more explanation about what this would mean for companies and for supervisors, as well as potential expense in adding a new layer of capital requirements.

Commissioner McCarty said the memo touches on other aspects of the supervisory capital adequacy assessment process that would work in tandem with an ICS. There is a question about whether the framework should result in clearly defined and enforceable actions for breach of the ICS requirement or a more flexible approach. He added that the U.S. solvency framework has always focused on the importance of other regulatory elements in addition to capital requirements; however, state insurance supervisors do have clearly defined enforceable actions for breach of RBC action levels, which would seem appropriate for an ICS calibrated to recognize the other elements of a supervisory framework. So the level of the ICS and flexibility to recognize other solvency protections both above and below action level triggers areas is where the NAIC will be interested in monitoring and in shaping developments.

Mr. Broadie supported using a flexible approach and added that using flexibility would be consistent with the NAIC’s approach to ComFrame. He added that an insurer’s supervisory colleges would be an appropriate place to determine what the action should be.
Commissioner McCarty thanked the interested parties for their input and noted that discussions on the development of the ICS would continue. He noted that the other major IAIS capital development currently being discussed is the BCR, which would be out for consultation over the summer.

Having no further business, the ComFrame Development and Analysis (G) Working Group adjourned.