In response to the 2008 global financial crisis, the Group of Twenty (G-20) Finance Ministers and Central Bank Governors created the Financial Stability Board (FSB) in 2009 as a successor to the Financial Stability Forum (FSF). The FSB, founded in 1999 by the G-7 finance ministers and central bank governors, was re-established as the FSB with an expanded membership and broader mandate to address vulnerabilities affecting the global financial system, and to develop and promote the implementation of effective supervisory and regulatory policies promoting financial stability. The FSB membership now includes, in addition to prior FSF members, all G-20 economies, Spain and the European Commission.\(^1\)

Since the financial crisis, the FSB has advanced a major program of financial regulatory reforms to address the shortcomings in the financial system exposed by the crisis, while striving to create globally consistent rules and a level playing field across countries and sectors. The FSB has also been tasked with providing recommendations and exploring how to treat global systemically important financial institutions (G-SIFIs) so as to prevent another financial crisis.

The FSB defines G-SIFIs as “institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries.”

A global systemically important bank (G-SIB), is one class of G-SIFI. Another class of G-SI are global systemically important insurers (G-SIIs). As insurance markets have become increasingly global and interconnected, and activities they engage in become increasingly tied to the financial markets, the FSB asked the International Association of Insurance Supervisors (IAIS) to set up a process to identify G-SIIs.\(^2\) In response to the request, the IAIS established an assessment methodology to assist in identifying G-SIIs, and in July of 2013 published a set of policy measures that would apply to them.

One of the policy measures recommended is higher loss absorbency (HLA) which represents the additional capital required to address the systemic nature of these insurer-led groups. Rather than have the HLA be added as uplift on jurisdictional capital requirements, the FSB instead asked the IAIS to develop a consolidated backstop capital requirement—subsequently changed to basic capital requirement (BCR)—as a comparable base for applying the HLA uplift.

In addition to its focus on G-SIIIs, the IAIS, in July 2010, began developing its Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame).

As part of these important initiatives, the IAIS is currently simultaneously developing the following work streams:

- **ComFrame** which will apply to all Internationally Active Insurance Groups (IAIGs).
- A **BCR** that is being developed for G-SIIs. A methodology for calculating the BCR is due later this year.
- An **HLA** to be applied to G-SIIIs starting in 2019. A recommended approach for HLA is due by late 2015.
- A **group-wide insurance capital standard (ICS)** which will become part of ComFrame and is expected to apply to all IAIGs beginning in 2019. The IAIS indicates that the objective is to complete crafting the ICS by the end of 2016.

**ν ComFrame**

ComFrame is a set of international supervisory requirements focusing on the effective group-wide supervision of IAIGs. ComFrame sets out a comprehensive range of qualitative and quantitative requirements specific to IAIGs, as well as the supervisory processes and prerequisites for supervisors to implement ComFrame. ComFrame is built and expands upon the high level requirements and guidance currently set out in the IAIS Insurance Core Principles (ICPs) which generally apply on both a legal entity and a group-wide level.\(^3\)

ComFrame is structured in three modules with each module made up of a number of elements. Module 1, Scope of ComFrame, includes the criteria and process for the identification of IAIGs by supervisors, the scope of the IAIG subject to group-wide supervision and the identification of the group-wide supervisor. Module 2, The IAIG, contains the requirements supervisors will require an IAIG to meet. Module 3, The Supervisors, covers the process of supervision, highlighting the role of the group-wide supervisor and other relevant supervisors’ responsibilities within the process as well as supervisory process, enforcement, cooperation and interaction requirements.\(^4\)

---

\(^{1}\) CIPR Financial Stability Board Key Issue Topic Page ([www.naic.org/cipr_topics/topic_financial_stability_board.html](http://www.naic.org/cipr_topics/topic_financial_stability_board.html)).

\(^{2}\) The IAIS is the international standard-setting body for the prudential supervision of the insurance industry.


\(^{4}\) CIPR ComFrame Key Issue Topic Page ([www.naic.org/cipr_topics/topic_comframe.html](http://www.naic.org/cipr_topics/topic_comframe.html)).

(Continued on page 22)
The development phase of ComFrame began in 2010 and concluded at the end of 2013. The field testing process began in 2014 to evaluate ComFrame in practice so it can be modified as necessary prior to formal adoption. The IAIS is currently scheduled to formally adopt ComFrame at the end of 2018, with its members implementing ComFrame thereafter.

**Basic Capital Requirement**
The IAIS has developed six principles to guide development of the BCR. These principles provide a high-level framework against which approaches and proposals may be reviewed. The principles are as follows:

Substantive Principles:

**BCR Principle 1: Major risk categories should be reflected.** The BCR must reflect major insurance risks, including risks from assets and liabilities, as well as non-insurance risks.

**BCR Principle 2: Comparability of outcomes across jurisdictions.** Outcomes should be comparable across jurisdictions. This implies the need to minimize distortions, including those arising from differing levels of conservatism included in valuation processes. The level of discretions that may be applied or introduced should be minimized across jurisdictions and over time.

**BCR Principle 3: Resilience to stress.** The BCR should be able to function in a wide variety of circumstances (including a stressed macro environment) and remain valid. Approaches adopted should be testable against historic data and will be developed with the goal G-SIIs continue as “going concerns.”

Construction Principles:

**BCR Principle 4: Simple design and presentation.** The design of the BCR needs to be pragmatic and practical. The form of presentation of the BCR, focusing on meaningful communication to external parties, should be “simple” and “intuitive” at a high level, yet sufficiently granular for the results to be fit for purpose. The BCR should utilize the minimum number of parameter and data requirements while attaining valid and robust outcomes with a focus on material issues.

**BCR Principle 5: Internal consistency.** The structure of the BCR needs to be consistent and should be applicable over the range of insurance and non-insurance entities it will need to cover and over time.

**BCR Principle 6: Optimize transparency and use of public data.** The level of transparency, particularly with regard to the final results provided, and the use of public data should be optimized.

Development of the BCR is the IAIS’s current highest priority. Several NAIC staff members, state insurance regulators and representatives of U.S. federal agencies are involved in this work which is expected to deliver a comparable base capital upon which to add the HLA capital requirements for G-SIIs. In December 2013, the IAIS released a consultation paper on BCR which was, at that time, in its early stages of development. Responses to the key themes of the BCR consultation paper were discussed and a large number of comments from observers were considered in its further development.

The current thinking is the BCR will apply factors to exposures that proxy various categories of risk (e.g., assets, life insurance, non-life insurance, asset liabilities management, as well as non-traditional insurance and non-insurance activities). In order to help craft the BCR, the IAIS commenced a quantitative field testing study on March 21, 2014, and a number of IAIGs from various jurisdictions have volunteered to participate in the study. The initial data is expected to be provided in May 2014 and analyzed over the following several months. The level the BCR will be set without HLA (as well as in combination with HLA) is a significant area of deliberation. A second consultation on the BCR is then expected to take place in the summer of 2014, to be approved by the IAIS and then go to FSB in the fall for its review. The IAIS hopes the proposal will be endorsed by the G-20 in November 2014.

**Higher Loss Absorbency**
Implementation of the BCR as a base for HLA is expected in 2019 after a period of review and analysis. The methodology for the HLA uplift will be developed during the second half of 2014 and the first half of 2015. The IAIS expects the ICS will ultimately replace the BCR as the base capital for G-SIIs upon which the HLA will be added.

It is unclear how the ICS will interact with the BCR, given they may both be operative in 2019. The IAIS hopes this will crystalize once the field testing begins and the timing for jurisdictional actions necessary to adopt the ICS (and ComFrame more broadly) is determined.

(Continued on page 23)
INSURANCE CAPITAL STANDARD
The ICS is a quantitative part of ComFrame. Development of the ICS is in its initial stages, but some initial thoughts and key points have been developed and will continue to evolve as the work moves forward. The capital component of the solvency assessment in ComFrame, which is currently being finalized in concept, will be used as a starting point for development of the ICS. The IAIS is committed to developing the ICS by end-2016 and full implementation is scheduled to begin in 2019 after two years of testing and refinement with supervisors and IAIGs.

The IAIS hopes that the ICS will provide a more comparable measure of capital across jurisdictions. The common understanding of IAIG capital adequacy will enhance supervisory cooperation and coordination among group-wide and host supervisors. It will also allow host supervisors to have greater confidence in the group-wide supervisor’s decisions and analysis.

While neither the BCR nor the ICS are expected to replace jurisdictional entity-based insurance capital requirements, there will be continuing discussion at the IAIS about how the ICS might interact with U.S. risk-based capital (RBC) legal entity requirements and RBC ratios. Both are being designed to pick up financial risk and material non-financial risk from all sources within the group, including risk emanating from entities that were heretofore not subject to entity-based regulation.

SUMMARY
There are many international capital-related work streams in process, some of which impact one another. It requires significant effort to follow all the nuances of each and every aspect of each and every proposal attached to the ongoing work. The IAIS is working with volunteer IAIGs to develop short-term and longer-term group capital standards, and will continue to issue consultation papers along the way to make sure the results of the work are transparent and ultimately beneficial to financial stability and policy-holder protection.

The NAIC is keeping abreast of developments through staff participation in all the relevant IAIS committees. In addition, NAIC members are assessing the impact on current U.S. insurance capital requirements via the open committee process. The Financial Stability (EX) Task Force is monitoring progress related to systemic risk and G-SIs. The newly formed ComFrame Development and Analysis (G) Working Group will assess developments pertaining to ComFrame generally and to the capital standards specifically including how these initiatives will interact with the U.S. state-based system of insurance regulation. The Working Group will use the usual channels of participation to keep regulators and interested parties informed and involved.

ABOUT THE AUTHOR
Josh Windsor is an actuary who recently joined the NAIC after nearly 20 years of insurance-related experience. In his current role, he joins the Financial Regulatory Affairs, International Policy & Market Surveillance unit where he will lend his technical actuarial expertise and regulatory experience to a variety of national and international projects. He comes to the NAIC from a consulting firm that serves regulator clients on a variety of projects, including the risk-focused examination of insurance companies, risk assessment and capital requirements for various insurance entities. Windsor is a fellow of the Society of Actuaries, a fellow of the Institute and Faculty of Actuaries and a member of the American Academy of Actuaries. He is also the Secretary of the Actuarial Society of New York.

Lou Felice is the health and solvency policy advisor at the NAIC. His role is to provide technical and policy analysis and advice to NAIC senior staff and leadership on solvency matters generally, including the solvency impact of the federal Affordable Care Act, as well as advising on enhancements to U.S. RBC and representing the NAIC in international dialogues and projects related to solvency and capital requirements. Before joining the NAIC, Felice served as chief of the Health Bureau at the New York State Department of Financial Services. Felice was co-recipient of the NAIC’s 2010 Robert L. Dineen Award for Outstanding Service and Contribution to the State Regulation of Insurance.
To subscribe to the CIPR mailing list, please email CIPRNEWS@NAIC.org or SHALL@NAIC.ORG