REPORT TO CONGRESS

The Impact of the International Insurance Capital Standard on Consumers and Markets in the United States

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Executive Summary

Under section 211(c)(3) of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),[1] the Secretary (Secretary) of the U.S. Department of the Treasury (Treasury), the Chair (Chair) of the Board of Governors of the Federal Reserve System (Board), and the Director of the Federal Insurance Office (FIO) shall, in consultation with the National Association of Insurance Commissioners (NAIC), complete a study on, and submit to Congress a report on the results of the study, the impact on consumers and markets in the United States before supporting or consenting to the adoption of any final international insurance capital standard.

To support financial stability following the Global Financial Crisis, the Financial Stability Board requested that the International Association of Insurance Supervisors (IAIS) develop a groupwide supervisory and regulatory framework, including a quantitative group capital standard, for large, internationally active insurance groups (IAIGs).[2] An appropriate capital standard could enable IAIGs to absorb losses and continue operations through stress and provide relevant, comparable information for supervisors across jurisdictions. The FIO and the Board (the agencies) as well as the NAIC and state insurance authorities (together, the states) participated in the resulting work at the IAIS to develop the global Insurance Capital Standard (ICS).

The agencies have undertaken a study to evaluate and analyze the impact of the ICS on U.S. consumers and markets. This work included participation in the efforts to develop the ICS and in the subsequent five-year monitoring period, frequent engagement with industry stakeholders, consultation with industry experts, analysis of confidential data collected from U.S. insurers, and attempts to address flaws in the ICS. This study reviews work by the Insurance Policy Advisory Committee (IPAC) of the Board and responses to a Request for Information (RFI) by the FIO on the ICS.[3]

Data availability and confidentiality restrictions materially impacted this study. Confidentiality agreements limited what the agencies could do with the ICS data submitted by IAIGs to the IAIS as well as what the agencies can disclose in this report. The agencies do not regulate any IAIGs and do not have access to non-public ICS data other than aggregated and anonymized data. These limitations prevented the agencies from quantifying the range of impacts of the ICS.

The impacts of the ICS would depend on whether and how it is implemented by the states. The IAIS develops global insurance standards but does not possess any legal power to impose its

[1] 31 U.S.C. § 313 note.

[2] Financial Stability Board, Global Systemically Important Insurers (G-SIIs) and the Policy Measures that Will Apply to Them (2013), https://www.fsb.org/uploads/r_130718.pdf.

[3] 85 Fed. Reg. at 64,228.

standards on its members. Implementation of the ICS, as prescribed by the IAIS, would have both costs and benefits, which are discussed below. Numerous issues were observed with the ICS during its development and testing. The agencies and states proposed changes to address elements that could have led to inaccurate solvency signals for U.S. insurance groups. Several of these changes were incorporated into the ICS, but the data collected do not allow the agencies to evaluate the impact of the changes over a business cycle and the related effects on U.S. consumers.

Given the potential negative effects of the ICS, the states have indicated that the ICS is not appropriate for the U.S. insurance market. The states plan to implement the Aggregation Method (AM) and have sought recognition by the IAIS that the AM results in comparable supervisory outcomes to the ICS. The AM was developed by the United States as an alternative group capital method to the ICS, under which existing local regulatory capital results are utilized and aggregated. The AM is expected to be implemented through the NAIC Group Capital Calculation (GCC), which was incorporated by the NAIC into NAIC's Insurance Holding Company System Regulatory Act in 2020. This NAIC act needs to be implemented by the individual states in order to be authorized. All states that serve as groupwide supervisors of U.S. IAIGs have adopted the GCC. Therefore, the implementation of the AM, via the GCC by U.S. state insurance authorities, is not expected to introduce significant changes to existing regulatory requirements or have significant impacts overall on U.S. insurers, consumers, and markets.

Introduction

This report is submitted by the Secretary of the Treasury, the Chair of the Board, and the Director of the FIO pursuant to section 211(c)(3) of EGRRCPA.[4] EGRRCPA directs the Secretary, the Chair, and the Director of the FIO, in consultation with the NAIC, to complete a study on, and submit to Congress a report on the results of the study, the impact on consumers and markets in the United States before supporting or consenting to the adoption of any final international insurance capital standard.

This report assesses the impact of the ICS, which is being developed by the IAIS. The ICS is a consolidated group capital standard applicable to IAIGs.[5] This work included participation in the efforts to develop the ICS and in the subsequent five-year monitoring period, frequent engagement with industry stakeholders, consultation with industry experts, analysis of confidential data collected from U.S. insurers, and attempts to address flaws in the ICS. This study reviews work by the Insurance Policy Advisory Committee (IPAC) of the Board and responses to an RFI by the FIO on the ICS.[6]

The states intend to implement the AM. The AM is being developed by U.S. participants at the IAIS as an alternative to implementing the ICS in the United States.

[4] 31 U.S.C. § 313 note.

[5] For a definition of IAIG and criteria, see IAIS, *Insurance Core Principles and Common Framework for the Supervision of Internationally Active Insurance Groups,* IAIS Insurance Core Principles, ICP 23 *Group-wide Supervision,* 23.0.a (November 2019) at https://www.iaisweb.org/uploads/2022/01/191115-IAIS-ICPs-and-ComFrame-adopted-in-November-2019.pdf.

[6] 85 Fed. Reg. at 64,228.

Background

IAIS Overview

Established in 1994, the IAIS is an organization composed of insurance supervisors from over 200 jurisdictions who participate in developing and assisting in the implementation of global standards and providing guidance and supporting materials for the supervision of the insurance sector.[7] The IAIS develops standards but does not possess any legal power to impose its standards on its members.

The IAIS approves standards that it issues through a committee system. The Executive Committee (ExCo) is the principal decisionmaking body of the IAIS. ExCo voting membership is selected by region. All U.S. voting member ExCo seats are held by the states. The FIO serves as a permanent nonvoting member of the ExCo. The Board currently has two nonvoting members of the ExCo. Standards are generally also subject to approval at a general meeting of IAIS members. The Board is a voting member at general meetings. The FIO, as a non-supervisory authority, is not a voting member at general meetings. Staff from the agencies and states participate on the committees and subcommittees that developed the ICS.

Insurance Regulation in the United States

At the individual state level in the United States, each state's legislature enacts insurance laws and empowers authorities within that state to implement and enforce those laws. The implementation of insurance regulation at the state level is generally composed of a core set of insurance regulatory standards supported by the NAIC accreditation program and generally leads to a substantively consistent high-level implementation of NAIC Model Laws covered by the program. NAIC Model Laws are not binding upon the individual states, and the respective regulations must be adopted through state law or regulation.

At the federal level in the United States, the FIO has certain statutory authorities pursuant to the Federal Insurance Office Act of 2010.[8] Among other functions, the FIO has authority to coordinate federal efforts and develop federal policy on prudential aspects of international insurance matters, and consult with the states (including state insurance regulators) regarding insurance matters of

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[7] See the IAIS web page at https://www.iaisweb.org/about-the-iais/what-we-do/.
[8] See 31 U.S.C. §§ 313-314.

national importance and prudential insurance matters of international importance. The FIO also represents the United States, as appropriate, at the IAIS.[9]

The Board is responsible for, among other things, the supervision of the U.S. depository institution holding companies that are significantly engaged in insurance activities. The Board currently supervises five such organizations, none of which are IAIGs. The Board has established a tailored supervisory framework and capital requirements for these organizations that reflect the differences between banking and insurance.[10] In addition, section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) authorizes the Financial Stability Oversight Council (Council) to determine that a nonbank financial company will be subject to supervision by the Board and prudential standards.[11] Under section 165 of the Dodd-Frank Act, the Board is responsible for establishing the prudential standards that will be applicable to a nonbank financial company subject to a Council determination.[12] No nonbank financial company is currently subject to a final determination of the Council under section 113 of the Dodd-Frank Act.

U.S. Insurance Capital Frameworks

State insurance authorities set minimum operating capital levels via the Risk-Based Capital framework as adopted by individual states via the NAIC Risk-Based Capital Model Acts for life, health, and property and casualty (P&C) organizations. The Board has established capital requirements for its supervised insurance organizations based on its Building Block Approach (BBA) framework.[13] The NAIC, through the states, also has adopted the GCC, which serves as an analytical tool for assessing capital adequacy at a group level.

NAIC Risk-Based Capital Formula and Group Capital Calculation

The NAIC risk-based capital (RBC) formula is applied to U.S. licensed insurance companies to calculate an RBC requirement that represents a statutory minimum level of capital. There are separate RBC formulas for each of the primary insurance lines of business: life and fraternal, health, and P&C. The purpose of the RBC requirement is to provide state insurance authorities with a tool to measure insurance companies' financial condition and facilitate timely regulatory actions. Consequently, the RBC framework stipulates capital intervention levels that enable or mandate

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9 IAIS, "List of IAIS Members," https://www.iaisweb.org/uploads/2022/04/List-of-IAIS-Members.pdf.

10 See Framework for the Supervision of Insurance Organizations, 87 Fed. Reg. 60,160 (October 4, 2022) and 12 C.F.R. pt. 217 subpt. J.

11 12 U.S.C. § 5323.

12 12 U.S.C. § 5365.

13 Regulatory Capital Rules: Risk-Based Capital Requirements for Depository Institution Holding Companies Significantly Engaged in Insurance Activities, 88 Fed. Reg. 82,950 (November 27, 2023).

various supervisory actions.[14] These supervisory measures vary depending on the capital deficiency indicated by the RBC result.[15]

The GCC is an analytical tool for use in solvency monitoring that was incorporated by the NAIC into its Model Insurance Company System Regulatory Act in 2020. The GCC is calculated by adjusting and aggregating local legal entity capital requirements. The objective of the GCC is to provide groupwide insurance supervisors with additional analytical information in assessing group level risks and capital adequacy. The GCC applies to all supervised insurance groups and is used only as a supervisory tool. It does not incorporate mandatory capital intervention levels.[16] The states expect to implement the AM via the GCC.[17]

The Board's Building Block Approach

In 2023, the Board established risk-based capital requirements for depository institution holding companies significantly engaged in insurance activities that are supervised by the Board.[18] These requirements include a capital adequacy measurement framework referred to as the Building Block Approach. Similar to the GCC, it builds on existing state-based RBC by adjusting and aggregating local legal entity capital requirements to determine enterprisewide required capital. Under the BBA, available capital is also aggregated and adjusted to derive a capital ratio of available capital divided by required capital. The final rule also contains an additional consolidated minimum RBC requirement that may exclude insurance activities, in compliance with section 171 of the Dodd-Frank Act.[19] These capital requirements differ from the requirements applied by the Board to most banking organizations in recognition of the differences between the businesses of banking and insurance.

IAIS Insurance Capital Standard

ICS Background

In response to a 2013 request by the Financial Stability Board (FSB), the IAIS is developing the ICS, a global insurance RBC standard for IAIGs. The ICS will be the quantitative component of the IAIS's Common Framework for the Supervision of IAIGs. The ICS is a minimum capital standard against which jurisdictional group solvency measurement approaches

[14] NAIC, *Risk-Based Capital Preamble,* https://content.naic.org/sites/default/files/inline-files/RBC_Preamble%20final_2.pdf.
[15] NAIC, *Risk-Based Capital* (June 1, 2023), https://content.naic.org/cipr-topics/risk-based-capital.
[16] For further information, see NAIC web page at https://content.naic.org/cipr-topics/group-capital-calculation.
[17] NAIC, *Provisional AM for Use in the Comparability Assessment*, 17 (September 13, 2023), https://www.iaisweb.org/uploads/2023/03/final-aggregation-method-comparability-assessment-criteria.pdf, section 5.2.
[18] 88 Fed. Reg. at 82,950.
[19] 12 U.S.C. § 5371.

would be assessed.[20] The ICS capital requirement calculation differs in significant ways from the BBA and GCC. Rather than an aggregation of local requirements, the ICS is performed at the level of the insurance group via the application of IAIS-specified stresses and risk factors with resulting amounts of required capital adjusted for diversification and tax effects.

As a groupwide, consolidated approach, the ICS aims to provide a comparable measure of group solvency to facilitate a common understanding of IAIGs' capital adequacy among global insurance supervisors. The IAIS expects that this approach would enhance cooperation and coordination among supervisors around the world.[21]

The ICS is currently in the final year of a five-year monitoring period, aimed at evaluating the performance and practicality of the ICS. The IAIS is planning to adopt the ICS as a global prescribed capital requirement (PCR) at the end of the monitoring period in 2024. If approved by the IAIS, IAIS member jurisdictions would be expected to implement the ICS as a capital requirement for their respective IAIGs, aligned with their respective market circumstances and legislative processes.[22]

The ICS applies only to insurance companies identified as IAIGs. Groupwide supervisors are responsible for the identification of IAIGs, after considering whether a group meets both the following criteria provided in ComFrame:[23]

- Internationally active:
  - premiums are written in three or more jurisdictions
  - gross written premiums outside of the home jurisdiction are at least 10 percent of the group's total gross written premiums
- Size (based on a three-year rolling average):
  - total assets are at least USD 50 billion or
  - total gross written premiums are at least USD 10 billion

[20] The International Monetary Fund performs Financial Sector Assessment Programs to assess the safety and soundness of a country's financial sector. This includes an assessment of regulatory capital frameworks against international minimum standards. The IAIS also plans to perform jurisdictional assessments of ICS implementation against the standard.

[21] IAIS, *Insurance Capital Standard as a Prescribed Capital Requirement, Public Consultation Document* (September 21, 2023), https://www.iaisweb.org/2023/06/public-consultation-on-insurance-capital-standard-as-a-prescribed-capital-requirement/.

[22] A prescribed capital requirement represents a "solvency control level above which the supervisor does not intervene on capital adequacy grounds." See IAIS, *Insurance Core Principles and Common Framework for the Supervision of Internationally Active Insurance Groups,* IAIS Insurance Core Principles, ICP *17 Capital Adequacy, 17.4* (November 2019), https://www.iaisweb.org/uploads/2022/01/191115-IAIS-ICPs-and-ComFrame-adopted-in-November-2019.pdf.

[23] IAIS, *Insurance Core Principles and Common Framework for the Supervision of Internationally Active Insurance Groups,* IAIS Insurance Core Principles, ICP *23 Group-wide Supervision, 23.0.a* (November 2019), https://www.iaisweb.org/uploads/2022/01/191115-IAIS-ICPs-and-ComFrame-adopted-in-November-2019.pdf.

According to the most recent register compiled by the IAIS, there were twelve U.S. IAIGs, of which three (Athene Holding Ltd.; Markel Group Inc.; and Pacific Life Insurance Company) were added to the list in 2023.[24] Box 1 provides a list of U.S. IAIGs.

Box 1. U.S. IAIGs (2024)

Life, Annuity, and Accident and Health

- American International Group
- Athene Holding Company
- MetLife, Inc.
- Pacific Life Insurance Company
- Prudential Financial, Inc.

Property and Casualty

- American International Group
- Berkshire Hathaway Inc.
- Chubb Group of Companies
- CNA Financial
- Fairfax Financial Holdings Limited
- Liberty Mutual Group, Inc.
- Markel Group

Reinsurance

- Berkshire Hathaway Inc.
- Markel Group
- Reinsurance Group of America, Incorporated

Source: IAIS, *Register of Internationally Active Insurance Groups Based on Information Publicly Disclosed by Group-Wide Supervisors* (October 30, 2024), https://www.iaisweb.org/uploads/2024/07/Register-of-Internationally-Active-Insurance-Groups-IAIGs.pdf.

U.S. Implementation of the Aggregation Method

The states, with support from the agencies, are developing the AM as an alternative to the ICS. As such, group capital adequacy of U.S. IAIGs would be based on the AM, rather than the ICS. The states expect to implement the AM via the GCC.[25]

The AM is based on the GCC and operates in a similar manner to the GCC. The goal of the AM is to leverage legal entity capital requirements to produce a measure of group capital adequacy allowing group-wide supervisors to analyze, identify, and address capital deficiencies where they arise within an insurance group's corporate structure. The AM adjusts and aggregates legal entity local capital requirements in a similar manner to the NAIC's GCC and the Board's BBA.

As of the date of this report, the AM is specified on a "provisional" basis, which serves as the basis for comparison in the IAIS's comparability assessment, as described below. Further steps are planned for the finalization of the AM, including a decision on a final methodology.[26]

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[24] IAIS, *Register of Internationally Active Insurance Groups Based on Information Publicly Disclosed by Group-Wide Supervisors* (October 30, 2024), https://www.iaisweb.org/uploads/2024/07/Register-of-Internationally-Active-Insurance-Groups-IAIGs.pdf.

[25] NAIC, *Provisional AM for Use in the Comparability Assessment*, 17 (September 13, 2023), https://www.iaisweb.org/uploads/2023/03/final-aggregation-method-comparability-assessment-criteria.pdf, section 5.2.

[26] NAIC, *Provisional AM for Use in the Comparability Assessment*, 17 (September 13, 2023), https://www.iaisweb.org/uploads/2023/03/final-aggregation-method-comparability-assessment-criteria.pdf.

AM Comparability Assessment Process

In 2019, the IAIS adopted ICS version 2.0 for the monitoring period and as part of this agreement, outlined a path to assess whether the AM provides comparable outcomes to the ICS. If deemed comparable, the AM will be considered by the IAIS and its members as an outcome-equivalent approach for implementation of the ICS as a PCR.[27]

According to the IAIS, "comparable outcomes to the ICS means that the [AM] would produce similar, but not necessarily identical, results over time that trigger supervisory action on group capital adequacy grounds."[28] The IAIS developed high-level principles and criteria to assess whether comparable outcomes are achieved.[29]

The states have made public statements that the ICS being proposed by the IAIS as a minimum standard would not be implemented in the United States.[30]

[27] IAIS, *Explanatory Note on the Insurance Capital Standard (ICS) and Comparability Assessment* (November 14, 2019), https://www.iaisweb.org/uploads/2022/01/191120-Explanatory-Note-on-the-ICS.pdf.

[28] IAIS, *Explanatory Note on the Insurance Capital Standard (ICS) and Comparability Assessment* (November 14, 2019), https://www.iaisweb.org/uploads/2022/01/191120-Explanatory-Note-on-the-ICS.pdf.

[29] IAIS, *Comparability Criteria that Will Be Used to Assess Whether the Aggregation Method Provides Comparable Outcomes to the Insurance Capital Standard* (March 9, 2023), https://www.iaisweb.org/uploads/2023/03/final-aggregation-method-comparability-assessment-criteria.pdf.

[30] See *U.S. Senate Committee on Banking, Housing & Urban Affairs: Hearing on Developments in Global Insurance Regulatory and Supervisory Forums* (September 12, 2019) (testimony of Eric A. Cioppa, Superintendent for the Maine Bureau of Insurance on behalf of the National Association of Insurance Commissioners), https://www.banking.senate.gov/imo/media/doc/Cioppa%20Testimony%209-12-19.pdf ("[W]e will not be implementing the current ICS in the U.S.") and *U.S. Senate Committee on Banking, Housing & Urban Affairs: Hearing on Current Issues in Insurance* (September 8, 2022) (testimony of Kathleen A. Birrane, Maryland Insurance Commissioner on behalf of the National Association of Insurance Commissioners), https://www.banking.senate.gov/imo/media/doc/Birrane%20Testimony%209-8-22.pdf.

Sources of Information for the Study on the ICS Impact on U.S. Consumers and Markets

This study of the impact of the ICS on U.S. consumers and markets was informed by various efforts by the agencies. Staff of the agencies and states participated in the development, testing, and analysis of the ICS, and through these efforts gained an understanding of potential impacts of the ICS on U.S. companies, consumers, and capital markets. Board staff also made several requests to the IPAC to study impacts, specifically targeting how the ICS would affect long-duration life insurance and retirement products.[31] In addition, the FIO issued an RFI to the public, requesting views on the potential effects of the ICS on the U.S. insurance market, its consumers, and insurers.[32]

Participation in the Development of the ICS

The IAIS began to develop the ICS in 2014. From 2014 through 2019, the IAIS collected data annually with participation from over 50 volunteer global insurance groups to evaluate the ICS and various design options. From 2020 to 2024, the ICS was subject to a monitoring period during which its design was held relatively stable in order to assess its performance over a period of time and to allow groupwide supervisors and supervisory colleges an opportunity to consider whether the ICS produced appropriate results. Staff from the agencies and states participated in these efforts. Industry stakeholders also were given regular opportunities to share their views directly with the IAIS and its members via workshops and teleconferences. The participation by U.S. members of the IAIS and U.S. volunteer insurance groups in ICS development and monitoring efforts provided significant input into the consideration of potential impacts of the ICS on U.S. capital markets and consumers.[33]

The data provided by volunteer insurance groups were subject to confidentiality requirements under which authorized users were required to be physically present at the Bank for International Settlements in Basel, Switzerland, to view company-specific data. The use of these data is also restricted to ICS field-testing and monitoring-period activities, and agency staff with access to these data are required to protect its confidentiality.

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[31] In 2018, Congress established the IPAC at the Board to advise on international insurance capital standards as well as on other insurance issues. See EGRRCPA § 211(b), Pub. L. No. 115-174, 132 Stat. 1296, 1317 (2018) (codified at 31 U.S.C. § 313 note).

[32] 85 Fed. Reg. 64,228.

[33] The U.S. member delegation at the IAIS is composed of staff from the Board, the FIO, state insurance authorities, and the NAIC.

Insurance Policy Advisory Committee Study

From 2020 to 2022, the IPAC conducted a study of the potential effects of applying the ICS to long-duration life and retirement products in the United States. The committee developed a "hypothetical" or stylized life insurer model to evaluate the impact on these types of products offered in the United States. The IPAC provided a report to the Board and distributed it to other regulators and stakeholders.[34] A summary of the relevant results of this study and the IPAC's conclusions are incorporated below in the sections Analysis of the Impacts of the ICS and U.S. Actions to Improve the ICS.

The IPAC followed up its impact study with an assessment of proposed ICS design changes that the IAIS was evaluating and testing during the monitoring period. These changes were intended to address unexpected results encountered in the annual data collection exercises, as well as input from ICS data volunteers and other stakeholders. The IPAC also provided detailed responses to an IAIS public consultation on the ICS as a PCR conducted in 2023. These materials were also considered in the study and are outlined in this report.

FIO Request for Information

The FIO issued an RFI in October 2020, soliciting views from the public on the potential effects of the ICS on the U.S. insurance market.[35] The FIO released the RFI after the IAIS adopted ICS version 2.0 (referred to as the reference ICS in 2019) and initiated a five-year monitoring period in 2020. As such, the public feedback received from the RFI was in response to the reference ICS. Fourteen comment letters were received. Respondents included ICS volunteer groups, insurance trade associations (both life insurance and P&C insurance market advocates), and other insurers whose operations could be affected by ICS implementation.

Responses to the RFI primarily supported the view that the application of the ICS to the U.S. insurance market would produce inappropriate supervisory signals, as risks of U.S. products and investments were not accurately reflected in the ICS.[36] Common concerns from respondents centered around artificial volatility from the market-based valuation methodology (MAV), which is the basis for the ICS balance sheet and overly conservative assumptions and risk calibrations underlying the ICS. Comments stated that the ICS design would promote an incentive structure that would impair policyholder protection and widen the life and retirement protection gap. Commenters expressed concerns that the MAV-related volatility and measurement of risks in the ICS

[34] IPAC, *Potential Impact of the International Association of Insurance Supervisors' Insurance Capital Standard on the Life Insurance Industry, Policyholders and Markets in the United States* (June 10, 2022), https://www.milliman.com/-/media/milliman/pdfs/2022-articles/IPAC-ICS-Paper-US-LT-Products.ashxa.

[35] 85 Fed. Reg. 64,228.

[36] Regulations.gov, "Federal Insurance Office Study on the Insurance Capital Standard," https://www.regulations.gov/document/TREAS-DO-2020-0019-0001/comment.

framework would introduce the possibility of false signals regarding capital adequacy, detracting from effective supervisory oversight. Moreover, commenters asserted that the ICS could lead to regulatory capital arbitrage by not reflecting local product attributes and practices that impact risk exposure, which could allow companies to increase risk without a corresponding increase in the ICS capital requirement. Finally, commenters stated that the inherent volatility and prescriptive nature of the ICS would conflict with well-established asset liability management (ALM) practices of life insurers, undermining long-term asset-liability matching and potentially resulting in procyclical effects.

Commenters encouraged the FIO's engagement in the AM comparability work at the IAIS, arguing that because of its perceived design flaws, the ICS should not be used as the benchmark against which the AM is measured as an alternative group capital approach. Rather, the AM should, in commenters' views, be evaluated based on its own prudential merits in addressing solvency for U.S. IAIGs.

The Appendix summarizes certain themes from the comments to the FIO's RFI.

Analysis of the Impacts of the ICS

The impact of the ICS on U.S. consumers and markets would depend on whether and how it is implemented by the states. While the states have expressed that they will not adopt the ICS, the agencies and states did analyze how the ICS may affect U.S. IAIGs. As such, this report considers two potential implementations of the ICS: implementation through an IAIS-specified ICS and implementation through the AM. The report assesses the impact of both of these potential implementations as compared to a baseline of current state policy on capital regulation in the United States.

The agencies are unable to quantify the range of impacts of the application of either potential implementation because of data limitations and confidentiality restrictions. As discussed above, ICS and AM data submitted to the IAIS are confidential, and the agencies cannot disclose even summarized non-public ICS and AM data. GCC data are also confidential, and the agencies do not have access to such data. The agencies do not regulate any companies within the scope of this standard and do not have access to non-public ICS data other than in a highly aggregated and anonymized form. Aggregated and anonymized data volunteered by six large U.S. life insurers were used as part of the IPAC's stylized model of the ICS. This model was useful for understanding outcomes of the ICS over a range of possible scenarios; however, it was intended only to analyze aspects of the ICS for certain product types rather than to quantify overall costs and benefits of the ICS.

The states have expressed their plans to implement the AM via the GCC rather than implementing the ICS. As the GCC is already implemented and relies on the existing state-based insurance regulation framework, IAIGs likely would not be required to make substantial changes to their existing processes and systems to adopt the AM. It likely would have minimal incremental impacts, if any, on U.S. markets and on product availability and cost for consumers. While some differences exist between the provisional AM and GCC, these differences are observed to be relatively small.[37] However, these differences between the AM and GCC could change in the future, and it is not possible to assess the range of possible future changes at this time.

The ICS as specified by the IAIS is a minimum standard that allows some flexibility at the jurisdictional level for national discretion and for other methods for calculating capital requirements, including the use of supervisor-approved internal models. For purposes of this report, the ICS is

[37] The scaling methodology, which adjusts capital requirements from international regulatory regimes to a level that is comparable to NAIC RBC in the GCC, is a potential exception. The provisional AM uses an unscaled approach, while the GCC uses an excess relative ratio scalar approach. Further details on these approaches can be found in the NAIC's provisional AM document (see note 25). For most companies subject to the GCC, scalars have little impact because most business is assessed using NAIC RBC. The impact on IAIGs would be more significant. Another difference between the GCC and AM is that the provisional AM is calibrated to 300 percent NAIC RBC, while the GCC uses 200 percent.

assumed to be applied as specified by the IAIS in the 2024 ICS data collection technical specification (candidate ICS).[38]

Effects on Capital Levels

The impacts of the candidate ICS on U.S. capital markets and consumers would be larger relative to the baseline. One of the most significant impacts could be if the ICS resulted in IAIGs operating with different levels of capital than they currently hold because of factors such as local requirements and rating agency capital criteria. Capital helps to ensure that insurance companies can meet their obligations to policyholders and other counterparties when they become due and can continue serving households and businesses, including through times of stress.[39] Capital also helps to reduce potential externalities that could result from the guarantee of policyholder obligations through state guarantee associations.[40] Capital is a useful tool to strengthen the incentives for an insurer to manage its risk prudently. However, investors expect companies to earn a return on capital, so the cost of capital can affect both the price and availability of insurance.[41]

For U.S. life IAIGs, capital requirements were in large part higher and varied more over time under the ICS compared to aggregated local requirements.[42] Capital resources were observed to be higher or lower depending on market conditions. By contrast, analysis by U.S. members of the IAIS showed that for U.S. P&C IAIGs, the ICS was generally observed to produce a lower requirement and higher capital resources than both the aggregation of local requirements and rating agency criteria. Because of these local requirements and rating agency capital criteria, the lower ICS capital requirement would not be expected to result in P&C IAIGs operating with less capital. Additionally, P&C group capital resource levels benefit under the ICS because of differences in insurance reserve valuation between U.S. statutory accounting and the ICS.[43]

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[38] IAIS, *Instructions for the April 2024 Insurance Capital Standard (ICS) Data Collection Exercise of the Monitoring Period Project* (June 2024), https://www.iaisweb.org/uploads/2024/06/2024-ICS-data-collection-Technical-Specifications.pdf.

[39] National Association of Insurance Commissioners, *Risk-Based Capital Preamble,* (2019) https://content.naic.org/sites/default/files/committee_related_documents/RBC_Preamble%2520final_2.pdf. (Risk-based capital rules help to "ensure policyholders will receive the benefits promised without relying on a guaranty association or taxpayer funds. . . . The ultimate objective of solvency regulation is to ensure that policyholder, contract holder, and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute.")

[40] Robert Klein, "Principles for Insurance Regulation: An Evaluation of Current Practices and Potential Reforms," 37 *Geneva Papers on Ins.* 175, 179 (2012).

[41] Walter Kielholz, "The Cost of Capital for Insurance Companies," 25 *Geneva Papers on Ins.* 4 (2000).

[42] In addition to costs, higher capital requirements would have the benefits discussed further below.

[43] Under the ICS, reserves for expected claim payments are discounted and expected profits are recognized at issuance, whereas under U.S. statutory accounting, reserves reflect nominal payments and profits are recognized evenly over an insurance contract.

Outside of the confidential data analyses undertaken at the IAIS, the best available evidence on whether these different capital requirements would be appropriate was obtained from the IPAC's study on long-duration life and retirement products in the United States.

Through a stylized insurer model, which involved an aggregation of data from U.S. insurers into a hypothetical representative balance sheet, the IPAC presented the view that the ICS methodology contains an excess amount of conservatism for long-term products. The insurance liabilities associated with these products are primarily backed by investment-grade, fixed-income assets. In the United States, these assets typically earn a credit spread. The additional investment income is contemplated in U.S. product design and ultimately shared to some extent with policyholders. However, under the ICS, only a portion of this spread is included in the discounting of future cash flows that underpins the measurement of these insurance liabilities. In part, the IPAC argued that this lack of recognition of a portion of spreads was due to the ICS penalizing U.S. products through lower discount rates because the ICS does not appropriately recognize the ALM practices. This generates an imbalance between the liabilities and the assets in the ICS that the IPAC argued was not merited.[44] The IPAC contends that low solvency ratios resulting from excess conservatism may also create the perception by policyholders, owners of public insurers, and other stakeholders that the group's ability to continue in business is in doubt, which may impact their cost of capital.

The agencies and others observed that the results under the ICS did include a large amount of conservatism. Some ICS results for IAIGs diverged materially from the views of U.S. members of the IAIS and the rating agencies on their capitalization. In part because of these issues, Canada's Office of the Superintendent of Financial Institutions stated that it did not support the ICS's proposed design, which it thought would not allow its insurers to take reasonable risks.[45]

The IPAC also presented the view that the ICS valuation, in addition to embedding significant conservatism, can move unexpectedly and non-economically.[46] As presented in the IPAC report, long-term products are particularly impacted by volatility resulting from insurance liability measurement.[47] Because the ICS is a market value construct, market movements can impact both the insurance group's level of capital and the capital requirement significantly. One example of unexpected results captured by the stylized model was that capital resources were shown to remain stable in the first quarter of 2020, despite the sharp drop in interest rates (generally unfavorable

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[44] See IPAC, note 34.

[45] Office of the Superintendent of Financial Institutions, "OSFI Does Not Support the Proposed Design of the IAIS Global Insurance Capital Standard," news release, November 14, 2019, https://www.newswire.ca/news-releases/osfi-does-not-support-the-proposed-design-of-the-iais-global-insurance-capital-standard-861802993.html.

[46] The stylized model used in the IPAC report was based on actual asset and liability data provided by six U.S. life insurers using a simplified version of the ICS calculation.

[47] See IPAC, note 34.

for life insurers) and the increase in credit risk associated with the pandemic.[48] In this same model, the required capital for interest rate risk decreased over the same period, indicating that the modeled portion of ICS ratios actually *increased* during this stressful period.[49] The IPAC noted that these results "call into question the ability of the ICS to provide a meaningful solvency signal for U.S. long-term business during a stressed market environment."[50] In the second quarter of 2020, when market stress abated, modeled ICS capital resources surprisingly declined over 10 percent.[51] Several key sources of this non-economic volatility were identified by the IPAC, including the complex way that the discount rate for liabilities is calculated under the ICS, which involves segregating liabilities into three different buckets that use different discounting methodologies, and a simplified methodology to recognize credit spreads that did not take into consideration that credit spreads vary along with the tenor of bonds.

After the issuance of the IPAC report, revisions were made to the proposed ICS that attempted to address a number of these concerns regarding both excessive conservatism and non-economic volatility for long-term products.[52] Details on some of the more significant issues with the ICS that caused these concerns and the changes made to address them are provided in the section below. These changes were made only recently, however, and data do not exist to test their efficacy through a business cycle.

Other Costs and Benefits

Outside of the impact on capital levels, the ICS's implementation would be expected to have other costs and benefits.

First, related to costs, individual IAIGs in the United States would also incur significant one-time and relatively smaller ongoing costs to comply with the ICS. A new, complex calculation would require substantial investment in new systems, processes, and controls, as well as initial testing and validation.[53] The ICS also would impose a valuation framework that is not otherwise used in existing U.S. public filings or statutory regulatory reports. As a result, insurers' existing processes from current accounting and reporting systems would likely require significant modifications.[54] Companies may also be incentivized to spend significant resources in developing and maintaining internal models, as has become common in Europe.

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[48] See IPAC, note 34, at 28. Capital resources remained roughly constant from prior period because of offsetting discounting impacts.

[49] See IPAC, note 34, at 34.

[50] See IPAC, note 34, at 30.

[51] See IPAC, note 34, at 31.

[52] See IAIS, note 21.

[53] See IPAC, note 34.

[54] U.S. Chamber of Commerce, *Insurance Capital Standards and the Aggregation Method* (September 2019).

Other incremental costs of implementing the candidate ICS versus the AM would include training and ongoing information burdens associated with a new and different requirement. Training for frontline supervisors and other users of such information would be required. Market participants possibly would have initial difficulty understanding the ICS results or interpreting its signals alongside existing, and potentially divergent, solvency measures. These would require, at a minimum, additional time and effort to educate regulators, stakeholders, and the public on the ICS-based reporting.

In response to these costs, IAIGs may alter their business strategies and product availability. This was seen in other frameworks. The ICS design is fundamentally similar to the European Union's Solvency II framework in that it employs a market-adjusted valuation approach and a combination of risk factors and stresses to derive a solvency measure. Data indicate that insurers reduced their underwriting of long-term guarantees because of a combination of factors that included Solvency II's implementation and the sustained low interest rate environment at the time.[55]

The likelihood and degree of these impacts would be affected by whether the ICS capital requirement would be a binding constraint on the overall level of capital when compared to local regulatory capital measures such as state-based capital requirements and rating agency capital level expectations. If such regulatory measures and expectations require the maintenance of higher capital levels than the candidate ICS, on its own the ICS could have a smaller influence on business strategy and decisions.

Second, the implementation of the candidate ICS could have potential benefits. One of the possible benefits of the ICS would be that companies and their supervisors would have a comparable global benchmark to measure the capital adequacy of IAIGs. This could also aid international supervisors, including those in the United States, in evaluating the capital positions of international groups operating in global markets. The ICS also may provide an added level of transparency and understanding among international supervisors and facilitate in-depth discussions in supervisory colleges. It could also contribute to an improved global understanding of individual risk components and related sensitivity to market conditions and provide a tool to help supervisors achieve greater consistency and avoid international capital arbitrage. However, both comparability and transparency benefits may not be achieved because of the allowance for internal models within the candidate ICS.

Additionally, the ICS could provide another source of forward-looking, risk-sensitive information to include alongside the existing suite of supervisory risk-management tools, which could provide an early-warning indicator of potential problems, such as potential risk from a low-for-long interest

[55] In its Annual Report, Insurance Europe provided results of a survey indicating there were impacts from Solvency II on the availability of long-term insurance products in the European Union. Insurance Europe, *Annual Report 2018–2019* (2019), https://www.insuranceeurope.eu/publications/706/annual-report-2018-2019/.

rate scenario. Additionally, as a PCR, it could also help monitor whether minimum levels of group capital are maintained. These benefits, however, depend on the degree to which the ICS is an accurate indicator of potential problems. As noted above, the agencies observed issues with the ICS during the monitoring period. Changes to the ICS addressed some, but not all, of these issues.

The ICS could also decrease some compliance burden for U.S. companies to operate in international markets. U.S. consumers may further benefit from reduced regulatory fragmentation under the ICS, which could reduce the barriers to entry for some foreign insurers that operate under similar frameworks.

Implications for Products and Market Share

The impact of these costs and benefits of the candidate ICS on consumers and markets is affected, to some extent, by the market share held by these IAIGs. U.S. life and annuity IAIGs currently hold 14 percent of all U.S. life and annuity reserves, with a lower share in many retail markets. Competitive pressures in those markets may limit the ability of the IAIGs to pass along any increased costs caused by implementation of the candidate ICS to the consumers or affect the availability of products. One significant impact on these markets could be that the IAIGs are at a competitive disadvantage proportional to the increased costs discussed above. Conversely, there are several markets in which the IAIGs have a larger market share.[56] In its report on the ICS, the IPAC noted that IAIGs would likely be economically pressured to reduce or stop the sale of long-term products, pass additional capital-associated costs on to consumers, or change the product design to make it more capital efficient.[57]

The candidate ICS would have smaller impacts on P&C insurance markets and consumers than for life and annuity markets. The primary potential cost of the ICS, as well as the most significant potential benefits, could result from a change in the amount of capital with which companies operate. The ICS generally is less conservative than U.S. RBC and rating agency models. The market share of IAIGs in P&C markets is similar to that of life and annuity markets.

The impact on the reinsurance markets would generally be similar to the impact on the primary markets because the risks of reinsurance are assessed similar to the risks of the primary ceded contracts. There has been little evidence of stakeholder concerns that the ICS would negatively impact P&C or mortality reinsurance markets. Reinsurers in these markets typically operate globally in order to achieve the necessary scale to diversify the risks. Additionally, a significant portion

[56] Using the categories from the statutory annual statement and data on reserves, the IAIGs have a market share above 30 percent in individual other life insurance, group life contingent payouts, group universal life insurance, group variable life insurance, and group universal life insurance.

[57] See IPAC, note 34.

of the global reinsurance market, as well as the subsidiaries of U.S. reinsurers, already operate under regulatory frameworks similar to the candidate ICS, and the ICS generally does not produce higher capital requirements on this business, as discussed above.

While the market for offshore asset-intensive life and annuity reinsurance could see impacts, these impacts could not be quantified or observed because of limited data collected by the IAIS from these types of companies. This market has grown significantly over the past decade and has been the subject of considerable research and regulatory attention, including an analysis at the IAIS of the potential effects of differences in regulatory and supervisory frameworks.[58] The agencies and the IAIS are currently studying this issue.

[58] See IAIS, *Global Insurance Market Report (GIMAR)* (2023), *Mid-Year Update* (July 2024), https://www.iaisweb.org/uploads/2024/07/Global-Insurance-Market-Report-mid-year-update-2024.pdf.

U.S. Actions to Improve the ICS

While this report only assesses the potential impact of the alternatives discussed in the prior section, the agencies, as well as the states and the IAIS, did evaluate many ICS design alternatives over the course of the ICS's development. Negotiations based on the results of these analyses led to improvements in the ICS.

The U.S. members of the IAIS led efforts to enact changes in the design of the ICS to better reflect U.S. regulations, products, and the operation of U.S. insurance markets. U.S. members advocated for several key changes to the ICS that, while not eliminating the majority of the concerns, were intended to address several design shortcomings relevant for U.S. life insurers. As the ICS is being developed as a global minimum standard for application across the world, the ICS cannot always reflect U.S. market and regulatory practices. While national discretions could address some of the remaining concerns with the ICS, they would likely fall short in addressing all areas, in particular, those concerning the MAV balance sheet valuation methodology.

In order to describe the changes made to the ICS during the monitoring period and their impact on the ICS, it is necessary to consider the ICS calculation. The ICS ratio is a measure of the solvency of an IAIG. The ratio is calculated as the total amount of group capital that qualifies under the ICS's specified criteria, referred to as "qualifying capital resources," divided by the group capital requirement. The valuation framework underpinning the ICS is the MAV approach.

The MAV approach has a significant impact on the ICS ratio. More specifically, the level of capital resources in the numerator is highly sensitive to the change in value of insurance liabilities caused by the valuation approach. Under MAV, insurance liabilities are measured as two components. The first component is the "current estimate," which is calculated as the probability-weighted average of the present value of future cash flows associated with the liability. The method employed by the ICS to discount cash flows is central to the ICS calculation. The second component of measuring insurance liabilities is a margin over the current estimate (MOCE), which is intended to reflect the inherent uncertainty in the current estimate cash flows. The MOCE is added to the "current estimate" to arrive at the total insurance liability amount, which is referred to as the "technical provision."

The current estimate and the MOCE were observed by both U.S. members and U.S. life industry stakeholders to be overly conservative and volatile, as these levels were overly sensitive to short-

term market movements.[59] The IPAC report notes that some of that volatility was non-economic due to ICS design choices that did not appropriately consider the risk profile and asset liability management practices related to some long-term insurance products.[60] U.S. member analysis of the actual data provided to the IAIS supported these IPAC observations.

The U.S. members of the IAIS advocated for changes to the MAV discounting method that would help reduce this excessive conservatism and non-economic volatility in the ICS. The discounting methodology proposed in the IAIS 2023 public consultation ICS as a PCR,[61] when compared to the discounting methodology used in the reference ICS adopted in 2019, incorporates a more appropriate level of credit spreads for insurance products, particularly for products with cash flows that are well matched with the assets backing those products. These improvements should, to some extent, better reflect most fixed annuity products offered in the United States. In addition, MAV discounting now incorporates a spread term structure adjustment that more closely reflects how investment spreads differ by maturity in the market.[62] The MOCE calculation also was adjusted following the public consultation on ICS version 2.0, resulting in a more appropriate lower level of MOCE.[63] These changes to the ICS were observed by U.S. members to result in a more appropriate measure of long-term liabilities for insurers, including for U.S. traditional life and retirement savings products.

The U.S. members also supported modifications to the criteria for qualifying capital resources, leading to more consistency and a better alignment with how capital is recognized under the RBC system and insurance market practices in the United States.

[59] For more detailed comments and proposed resolutions see IAIS, *Summary of Main Comments Received during the 2018 Public Consultation on ICS Version 2.0 and Their Resolution* (November 20, 2019), https://www.iaisweb.org/uploads/2022/01/191120-Resolution-of-comments-ICS-Version-2.0-consultation1.pdf.

[60] The IPAC report on the potential impact of the ICS employed a stylized insurer model to demonstrate that the ICS is overly sensitive to short-term market conditions, producing both excessive conservatism and volatility in its measures of capital resources and capital requirement. See note 34.

[61] IAIS, see note 38.

[62] See section 5, Market-Adjusted Valuation, IAIS, *Public Consultation on Insurance Capital Standard as a Prescribed Capital Requirement* (September 21, 2023), https://www.iaisweb.org/2023/06/public-consultation-on-insurance-capital-standard-as-a-prescribed-capital-requirement/.

[63] See resolution of comment 5.2, IAIS, *Summary of Main Comments Received during the 2018 Public Consultation on ICS Version 2.0 and Their Resolution* (November 20, 2019), https://www.iaisweb.org/uploads/2022/01/191120-Resolution-of-comments-ICS-Version-2.0-consultation1.pdf.

Conclusion

In response to the Financial Stability Board's 2013 request, the IAIS developed a global PCR for IAIGs and is planning to vote to adopt the ICS in December 2024. While the IAIS's standards are not binding on its members (including the United States), several jurisdictions have expressed their intention to implement some form of the ICS in their respective local capital regulatory regimes. The agencies and states advocated for design changes to the ICS framework that are more appropriate for U.S. insurance products, U.S. insurance markets, and the U.S. regulatory system, in part to limit potential spillover effects to U.S. IAIGs with overseas operations.

The decision on the implementation of the ICS will be made by state insurance regulators, who are the primary supervisors of the U.S. insurance industry under the U.S. state-based system of insurance regulation. The states have decided to not implement the ICS, citing, among other things, concerns with the ICS's reliance on a market-based valuation methodology, non-recognition of certain financial instruments as qualifying capital, and lack of recognition of U.S. jurisdictional differences. Instead, the states have sought recognition by the IAIS of the AM as providing comparable outcomes to the ICS. The states also plan to implement the AM via the GCC. Given that the calculation and reporting of the AM would be facilitated via the GCC already adopted by the states, there would be little incremental cost or burden for U.S. IAIGs or impacts on U.S. markets and consumers.

Appendix: Themes from Comments to the FIO's Request for Information

Common themes from the comments to the FIO's October 2020 RFI are provided below.[64]

ICS Design Challenges

- By incentivizing certain activities (e.g., investment strategies that over-allocate to select "eligible" assets under the MAV methodology), the ICS could promote regulatory capital arbitrage and undermine prudent ALM strategies designed for policyholder protection.
- The excess conservatism embedded in the assumptions and parameters of the ICS disregards jurisdictional differences and rules, encouraging opportunities for regulatory capital arbitrage.
- A market-adjusted valuation framework as the ICS would be more volatile and poses the potential for significant procyclical effects (even amplifying them), which would likely exaggerate the solvency impact of short-term market movements and distort supervisory signals about capital adequacy.
- The ICS's punitive treatment on long-duration products with financial guarantees and the volatility produced by a market-adjusted framework provide strong disincentives for insurers to manufacture and market such products, impacting cost and availability of such coverage for consumers.
- As insurers are forced to retreat from providing long-term guarantee products under the ICS, there would be knock-on effects that include reducing the industry's appetite to provide financing through long-term debt instruments such as corporate bonds and infrastructure.
- The highly risk-sensitive nature of the ICS would not only increase volatility in U.S. insurance markets but could also adversely impact financial stability by driving risk concentrations that align with the incentive structure created by the ICS and exacerbate "fire sales" during periods of stress.
- While the purpose of the ICS is to provide insurance supervisors with a "common language" for risk capital across cross-border groups, the demarcation of IAIGs as being subject to a distinct capital treatment could result in competitive hurdles relative to non-IAIGs in the same domestic market.
- The ICS assumes complete fungibility of groupwide capital, masking deficiencies that can jeopardize group solvency in times of market duress.

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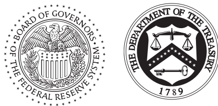
[64] Regulations.gov, "Federal Insurance Office Study on the Insurance Capital Standard," https://www.regulations.gov/document/TREAS-DO-2020-0019-0001/comment.

Comments in Support of Finding AM Comparable

- Significant costs—both one-time, for implementing the ICS, and ongoing, for maintaining it—would likely be passed on to consumers.
- Incentives for procyclical behavior created by the design of the ICS are not present under the statutory valuation underlying the AM.
- Because the AM leverages existing capital frameworks across jurisdictions, its implementation would be less disruptive to the competitive landscape than the ICS.
- By calculating capital on a group basis that disregards jurisdictional rules (including jurisdictional limits on the movement of capital) that apply at the entity level, the ICS could encourage arbitrage against those entity requirements.
- If the AM is not found to be comparable to the ICS, U.S. IAIGs would be subject to multiple standards (both the ICS abroad and the AM domestically), resulting in significant operational costs and risk management challenges that would likely place them at a competitive disadvantage in comparison to insurers operating in the same overseas markets and subject to a single standard.
- The AM provides transparency into fungibility constraints across regulated entities within the insurance group, revealing weaknesses where they reside under stressed conditions.



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