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Submitted for the Record

U.S. House Financial Services Subcommittee on Housing and Insurance Hearing  
Titled “The Impact of International Regulatory Standards  
on the Competitiveness of U.S. Insurers”  
April 29, 2015

Chairman Luetkemeyer, Ranking Member Cleaver, and distinguished Members of the Subcommittee:

On behalf of the American Academy of Actuaries’<sup>1</sup> Solvency Committee, I appreciate the opportunity to provide this written testimony for the Subcommittee on Housing and Insurance: “The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers.”

The International Association of Insurance Supervisors (IAIS) is developing group solvency and capital standards that could have a profound effect on internationally active insurance groups (IAIGs), including several U.S. insurers. As such, these international capital standards must be created in a careful, transparent, and meaningful manner. Failure to do so may undermine the ability of U.S. insurers to operate effectively and efficiently and could affect the financial stability of U.S. insurance industry.

To help guide both domestic and international policymakers through this process, the Academy’s Solvency Committee has created a comprehensive set of basic principles that we believe are essential to the development of effective group solvency and capital standards for insurers. Adhering to these principles will help policymakers and regulators alike create insurance capital standards that are appropriate for the insurance business model and do not harm U.S. insurance markets or consumers. These principles include:

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<sup>1</sup> The American Academy of Actuaries is an 18,500+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers 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.

1. A group solvency regime should be clear regarding its regulatory purpose and goals. For example, the purpose could be to protect policyholders, enhance financial stability, ensure a competitive marketplace, provide a level playing field, identify weakly capitalized companies, rank well-capitalized insurers, improve risk management practices and procedures, or some combination of the above. The regulatory purpose and goals will aid in the development of a standard itself, the associated regulatory actions, and priorities.
2. Any metrics, information, or other output of a group solvency standard should be useful to all relevant parties, including regulators, management, shareholders, and rating agencies.
3. A group solvency regime should promote responsible risk management in the regulated group and encourage risk-based regulation. For example, a solvency regime should recognize risk-mitigation activities, such as asset/liability matching, hedging, and reinsurance. Actuarial functions are critical in the risk management process and their role should be well defined, as it is in the U.S. reserving and solvency framework. Actuaries can and should identify where factor-based systems could miss emerging risks, set reasonable boundaries around estimates and modeling, and, as appropriate, render actuarial opinions.
4. Methods should recognize and take into consideration the local jurisdictional environments under which members of an insurer group operate, including the local regulatory regime, product market, and economic, legal, political, and tax conditions.
5. A group solvency standard should be compatible across accounting regimes, given the political uncertainties in achieving uniform standards.
6. A group solvency standard should minimize pro-cyclical volatility so as to avoid unintended consequences on insurance groups, insurance markets, and the broader financial markets.
7. A group solvency standard should present a realistic view of an insurance group's financial position and exposures to risk over an agreed-upon time frame.
8. All assumptions used in any capital or solvency model should be internally consistent.
9. It is more important to focus on the total asset requirement than the level of required reserves or capital on a separate basis. The focus should be on holding adequate total assets to meet obligations as they come due. Whether a jurisdictional standard requires the allocation of these assets to liabilities versus capital/surplus should be irrelevant to the overall solvency regime.
10. It must be demonstrated that the capital held is accessible, including in times of financial or economic stress, to the entity facing the risk for which the capital is required.

In addition to these principles, the Academy's Solvency Committee would like to provide a more detailed picture of the potential impacts of the IAIS's most recent proposed group solvency and capital standards. As the Subcommittee on Housing and Insurance continues its examination of

international insurance regulatory efforts, we hope you will bear in mind the Academy’s Solvency Committee’s response<sup>2</sup> to the IAIS on its *Risk-based Global Insurance Capital Standard* (ICS) public consultation document, dated Dec. 17, 2014, which we have summarized below.

### *Comparability*

The IAIS’s ICS should aim to be compatible across varying jurisdictional accounting regimes (i.e., between countries, states, and other international standards) without requiring a common valuation methodology for determining capital standards. Developing consistent valuation principles is likely to be very challenging and such principles are unnecessary to achieve a risk-based, globally comparable ICS. We note that the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have been unable to converge on accounting standards for insurance contracts, as developing a common balance sheet across jurisdictions is fraught with significant challenges. Furthermore, while we agree that it is important for regulators to be able to assess the risks faced by IAIGs, it is unclear whether a single capital ratio or a single risk factor for a similarly labeled product can result in true comparability across national boundaries or different insurance products. For example, the risk in auto insurance in a country with national health care and low incidence of civil litigation is different from the risk in auto insurance in a country without national health care and with high levels of claims filed.

### *Minimize Pro-Cyclical Volatility*

The ICS should minimize pro-cyclical volatility so as to avoid unintended and harmful consequences on regulated insurance groups, insurance markets, and the broader financial markets. For example, the business models for U.S. insurers writing long-term business often do not rely on a market-adjusted approach. If such an approach inconsistently adjusts the value of assets and liabilities for changes in credit spreads then, to the extent that the cash flows offset, this would create artificial changes in the capital calculations that are not accurate and could distort and/or hide the real risks that an IAIG might face.

### *ICS as a Minimum Threshold*

The ICS should be a minimum threshold for regulatory intervention. Functionally, a minimum threshold for intervention identifies groups that are financially troubled versus those that are financially sound. By definition, the “minimum threshold” for intervention will be a smaller amount of capital than any additional amount above the threshold that is needed to ensure that a company’s capital is “prudent” or “strong.” Implementing “target” capital levels above the minimum threshold will make comparisons between insurers and jurisdictions more difficult—particularly considering the differences among insurance markets, products, and lines of business globally—which works against the overarching goal of comparability.

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<sup>2</sup> [http://actuary.org/files/Solvency\\_Committee\\_ICS\\_Consultation\\_Response\\_Final\\_020615\\_0.pdf](http://actuary.org/files/Solvency_Committee_ICS_Consultation_Response_Final_020615_0.pdf).

We note that the ICS does not need to serve as the sole capital requirement in every jurisdiction. Some jurisdictions could impose more stringent group capital requirements and others also may impose capital requirements on a legal entity basis. If it is designed appropriately as a regulatory minimum, the ICS need not override these other requirements. Instead, the ICS can serve as a group-level, globally comparable floor on capital. Local requirements that are more sensitive to the particular features of each jurisdiction can define the amount of any capital that should be held above the floor.

### *Availability of Capital in Time of Stress*

It is important that the ICS is developed in a way that ensures assets are both accessible and available during a stressed situation. If capital is held in the location where the risk resides, regulators and policyholders can be assured that it will be accessible in a stressed situation. In contrast, if capital is in a different location, it may not be of use for addressing a stressed situation.<sup>3</sup> This can include situations such as funds subject to currency restrictions and funds held in one jurisdiction, where the regulator in that jurisdiction is unwilling or unable to allow funds to be used in other jurisdictions unless full payment to policyholders or creditors in his or her jurisdiction is assured.

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Thank you for this opportunity to provide our views on the impact of the proposed international regulatory standards on U.S. insurers. Actuaries have worked for many years with insurance and other financial sector policymakers to help develop prudent rules and regulations that address insurer solvency, including capital requirements. Actuarial expertise remains crucial to the creation of international and domestic insurance regulatory standards.

If you have any questions or would like to discuss these issues in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at 202.223.8196 or [sarper@actuary.org](mailto:sarper@actuary.org).

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<sup>3</sup> Note that this requires "location" to be defined in terms of regulatory authority, which may include both geographic and sector components.