AMERICAN ACADEMY *of* ACTUARIES

June 2, 2014

Senator Neil Breslin (NY)
President, National Conference of Insurance Legislators (NCOIL)
Chairperson, NCOIL International Issues Task Force
Via email: snolan@ncoil.org

Re: Recommendations for NCOIL International Priorities

Dear Senator Breslin –

On behalf of the American Academy of Actuaries'[1] Risk Management and Financial Reporting Council, I would like to submit the following topics in response to the request for recommendations on the top three priorities for 2014 action by NCOIL's International Issues Task Force.

Development of International Capital Standards

The various capital proposals under development at the International Association of Insurance Supervisors (IAIS) are moving quickly and could have a profound impact on U.S. insurance regulation and the U.S. insurance market. While state regulators acknowledge the effectiveness of the existing U.S. solvency framework, including the risk-based capital (RBC) formulas, there will be considerable pressure for the new international capital standards to apply to U.S. Global Systemically Important Insurers (U.S. G-SIIs) and Internationally Active Insurance Groups (IAIGs.) The U.S. financial and insurance regulatory systems are evaluated according to the World Bank and International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP); the standards against which the insurance regulatory system is measured are promulgated by the IAIS. The greater the differences between the IAIS and U.S. regulatory measures, the more pressure there could be to change the U.S. structure to be more like the IAIS. As such, it is important for U.S. insurance industry stakeholders, including NCOIL, to engage with the IAIS so that the standards developed (e.g., capital standards, supervisory practices, etc.) allow for the continued and effective distribution of products that fit the needs of the U.S. market.

In addition, the Federal Reserve Board (Fed), the U.S. Department of the Treasury, and the Securities and Exchange Commission (SEC) are all members of the Financial Stability Board (FSB), which is the organization directing the IAIS work. Per the Dodd-Frank Act, U.S. G-SIIs and insurance holding companies that also are savings and loan holding companies (SLHCs) have been placed under enhanced supervision by the Fed, including capital standards. A large percentage of the U.S. insurance market could be affected by these capital standards. As such, it is crucial that U.S. legislators and regulators consider the impact of capital standards on U.S. markets.

[1] The American Academy of Actuaries is an 18,000-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.

We believe action on this issue should be undertaken by the task force as soon as possible. The task force should encourage state and federal regulators to (1) consider the impact of the proposed IAIS capital standards on the U.S. insurance market and U.S. insurance regulation and (2) work collectively at the IAIS and FSB to ensure that U.S. regulatory needs and interests are met. Some action steps worthy of NCOIL consideration include strengthening NCOIL and state legislators' relationships with the Federal officials directly involved with the IAIS, familiarizing NCOIL with the IAIS proposals, pinpointing those areas where the NCOIL perspective will be most valued and can exert the greatest influence.

Group Supervision and Solvency Standards

Several issues related to the regulation or supervision of insurance groups have been raised in the aftermath of the financial crisis of 2008. Group supervision issues have been raised by the IAIS via ComFrame developments and revisions to Insurance Core Principle 23 (ICP 23) and by the NAIC via modifications to the Model Holding Company Act.

One overarching question from an international perspective is the choice of the group supervisor for U.S. IAIGs (i.e., U.S. IAIGs that are not G-SIIs or savings and loan holding companies). The designated group supervisor will be a key factor in determining if, and how, international solvency and capital standards are applied to U.S. insurance groups. As discussed above, the FSAP process creates pressure for the U.S. to comply with international regulatory standards, including group supervisory requirements. An effective U.S. state insurance regulatory system must include the ability for U.S. state regulators to function as group supervisors.

Another issue affecting insurance groups concerns the use, and appropriateness, of a group solvency standard. Underlying the U.S insurance regulatory system is the goal of protecting policyholders and ensuring that they receive the benefits promised. Policyholder protection is a key foundation of the U.S. regulatory approach and is further enhanced by state guaranty associations. While a group solvency standard, as contemplated by the IAIS, may have a place in insurance regulation, it is crucial that U.S. regulators not lose sight of policyholder protection and the importance of entity-level capital and solvency requirements.

We concur with the approach suggested by the NAIC in the original NCOIL issues compilation. We think the NCOIL International Issues Task Force should consider what enhancements, if any, are necessary to the U.S. approach to group supervision requirements and support the legislative changes necessary to implement those enhancements.

We recommend that analysis of this issue be completed in 2014.

Reinsurance

Numerous aspects of reinsurance regulation are gaining national and international attention. One issue receiving significant attention is the use of captive reinsurance for financing statutory reserves required by U.S. regulation. In its report on modernizing the regulation of the U.S. insurance industry, the Federal

Insurance Office (FIO) included recommendations on the use of wholly-owned captive reinsurance structures by life insurers. The FIO recommended that states develop "a uniform and transparent solvency oversight regime for the transfer of risk to life reinsurance captives." The FIO report stated that the lack of uniformity for regulating captives may undermine the comparability of the U.S. solvency regime with other jurisdictions.

The NAIC is considering several changes to the regulations covering life captives. We recommend that NCOIL's International Issues Task Force, along with NCOIL's Life Insurance and Financial Planning Committee, monitor the NAIC's plan to adopt uniform regulation and supervision of life captives (i.e., the Rector Report). We believe it is imperative that the issues around life captives be addressed in 2014, and we recommend that NCOIL and state legislators prioritize the resolution of concerns related to life captives in 2014.

Another aspect garnering attention relates to collateralization of reinsurance agreements. A debate about the amount of collateral, or if there should be collateral at all, has been occurring for more than 20 years. With the growing influence of the European Union (EU) and its desire for regulatory equivalence, it has become more important to reach resolution on the collateral issues.

The consequences from EU equivalence, increased market demand for reinsurance capacity, the NAIC Model Law, and FIO proposals related to collateral are forces that create momentum for a global agreement relating to collateral. In 2011, the NAIC passed a revised model law on collateral, but few states have passed it and few states are actively supporting the model law. We recommend that NCOIL work with the NAIC and its international equivalents to develop comprehensive collateral reform. Effective solutions will provide assurance that U.S. claims will be paid and will foster an economically viable international reinsurance presence.

The use of collateral to secure reinsurance agreements is both a U.S. and an international issue that requires the attention of the regulatory community. With the NAIC and FIO already weighing in on this issue, it is important that NCOIL and state legislators make their voices heard.

*****

We appreciate the opportunity to provide this input. We look forward to working with NCOIL on these international developments in the future and offer our assistance to NCOIL. If you have any questions, please contact me by phone (202-223-8196) or by email (Bennett@actuary.org).

Sincerely,

Nancy Bennett, MAAA, CERA, FSA
Senior Life Fellow
American Academy of Actuaries