November 25, 2024

IAIS Executive Committee Approves International Capital Standard; Finalizes U.S. Aggregation Method Comparability Assessment

IAIS Concludes that a U.S. Aggregation Method Can Be Implemented in a Manner that Produces Comparable Outcomes to the International Capital Standard

SUMMARY

On November 14, 2024, the Executive Committee of the International Association of Insurance Supervisors (IAIS) approved the final version of the global International Capital Standard (ICS) to be used as a prescribed capital requirement (PCR) for internationally active insurance groups (IAIGs).[1] The final ICS will be presented to IAIS members for adoption at the IAIS Annual General Meeting on December 5, 2024. Following adoption, the IAIS will, in 2026, coordinate a baseline self-assessment by IAIS members of their progress in implementing the ICS, and aims to begin targeted jurisdictional assessments on ICS implementation in 2027.

The IAIS Executive Committee also completed its assessment of whether the Aggregation Method (AM) developed by the United States in recent years provides comparable outcomes to the ICS, and documented its assessment in a report (AM Report).[2] The IAIS report concludes that a U.S. AM provides a "basis for implementation of the ICS to produce comparable outcomes," but highlights certain areas where work in connection with implementing the final AM will help ensure sufficient convergence with the ICS. Specifically, in respect of U.S. life IAIGs, the report calls out potential divergences in results between the AM and ICS under certain scenarios, particularly in a low-yield scenario, and instances over the business cycle where the AM may not be as prudent as the ICS in terms of the triggers for supervisory intervention on group capital adequacy grounds, while noting that the United States "commits" to

addressing these areas "in appropriate ways, which will be reviewed during the IAIS ICS implementation assessment process."

It is likely that the United States will be the only jurisdiction that employs an aggregation method to calculate insurance group capital requirements for IAIGs, as most other jurisdictions have adopted insurance group capital frameworks (such as, in Europe, Solvency II) that broadly mirror the ICS framework. Whereas the ICS and similar consolidated group capital frameworks (such as Solvency II) produce a single, standardized calculation at the group level based on a market-adjusted valuation approach, the AM relies on existing local capital requirement calculations at the level of each subsidiary that are then aggregated (subject to scalars and adjustments) to produce a uniform standard of group capital adequacy, which, for the AM, is based on the National Association of Insurance Commissioners (NAIC) risk-based capital (RBC) framework (a framework that does not generally follow the ICS market-adjusted valuation approach). The NAIC and state insurance regulators have stated that they plan to implement the AM by means of the existing NAIC Group Capital Calculation (GCC). As a result, U.S. IAIGs are unlikely be required to implement substantial changes to their existing group-capital processes and systems in connection with the adoption of the final ICS.

INTERNATIONAL CAPITAL STANDARD

Background

The IAIS consists of insurance supervisors and regulators from more than 200 jurisdictions, constituting 97% of the world's insurance premiums. U.S. members include the U.S. Department of the Treasury's Federal Insurance Office (FIO), the NAIC, state insurance regulators and the Board of Governors of the Federal Reserve (FRB). IAIS policy measures and financial reforms only take effect when enacted at the relevant jurisdictional level.

In response to a request by the Financial Stability Board (FSB), the IAIS announced its intention to develop a risk-based global insurance capital standard in 2013 and, following multiple quantitative field-testing exercises and public consultations, released ICS Version 1.0 in 2017. An updated version of the ICS, ICS Version 2.0, was adopted by the IAIS in 2019. ICS Version 2.0 was used for confidential reporting to IAIG group-wide supervisors, discussion in supervisory colleges, and further analysis by the IAIS during a five-year monitoring period (2020-2024), with the intent of adopting the ICS as a PCR for IAIGs by the end of 2024.[3] The IAIS launched a public consultation on a "candidate ICS" as a PCR in June 2023 (Candidate ICS). Once adopted as a PCR, the ICS is intended to constitute a minimum capital standard for IAIGs, which IAIS-member supervisors "will implement or propose to implement taking into account specific market circumstances in their respective jurisdictions."

The ICS forms the quantitative element of the Common Framework for the Supervision of IAIGs (ComFrame); the qualitative elements of ComFrame, including governance and risk management, were adopted in 2019. Under ComFrame, the group-wide supervisor is responsible for the identification of IAIGs, in cooperation with other involved supervisors, considering whether a group meets both the "internationally active" and "size" criteria used to define IAIGs: (1) premiums are written in three or more jurisdictions and gross written premiums outside of the home jurisdiction are at least 10% of the group's total gross written premiums; and (2) total assets are at least $50 billion or total gross written premiums are at least $10 billion (in each case based on a three-year rolling average). The IAIS maintains a list of IAIGs, which currently includes 59 insurance groups.[4]

Next Steps

While the ICS to be implemented as a PCR will be finalized in connection with its adoption in early December, the IAIS has indicated that only two minor amendments, relating to the mapping of credit risk ratings and the determination of non-insurance risk, will be made to the final ICS as compared to the last version of the ICS published in a June 2024 data collection package.

The IAIS intends to develop a detailed ICS implementation assessment methodology in 2025, followed by a two-step assessment: (1) a baseline self-assessment by members in 2026; and (2) in-depth targeted jurisdictional assessments by the IAIS beginning in 2027. The assessment's goal will be to analyze "whether the jurisdictional implementation at least meets the ICS (i.e., produces at least the same level of prudence as the ICS and similar triggers of supervisory intervention)."

AGGREGATION METHOD

Background

U.S. regulators and members of Congress have expressed concerns about the ICS, including that the market-adjusted valuation approach embodied in the ICS could lead to excessively volatile results and could undermine the ability of U.S. insurers to offer certain types of annuities, life insurance and other long-term products, and have asked that the IAIS instead recognize the AM as an outcome-equivalent approach. Most recently, in a report to Congress submitted on November 13, 2024, the Secretary of the U.S. Treasury Department, the Chair of the FRB and the Director of FIO indicated that "[t]he 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."[5]

In response to U.S. requests, the IAIS developed a process to assess, by the end of the ICS monitoring period (i.e., late 2024), whether the AM being developed by the United States provides "comparable (i.e., substantially the same (in the sense of the ultimate goal)) outcomes to the ICS" and could be considered by the IAIS as an "outcome-equivalent approach" for implementation of ICS as a PCR. Comparability criteria, including a definition of comparable outcomes, were progressively developed and were finalized in March 2023.[6]

U.S. Provisional AM

Unlike "consolidated" approaches to group capital such as the ICS, the AM relies on existing local capital requirement calculations at the level of each subsidiary, which it then aggregates (scaled to a uniform basis and after adjustments to remove double-counting) to produce a measure of group capital adequacy. The contribution of each legal entity to the total capital requirement is calculated as the product of an "exposure measure" (for regulated financial entities, this is the local capital requirement) multiplied by a "scalar" (or factor). Scalars are intended to correct for differences between solvency frameworks in order to harmonize required capital levels.

Two AM-based insurance group-wide capital regimes are currently being implemented in the United States:

- The NAIC's GCC, adopted in 2020, which is used to monitor the solvency of U.S. insurance groups. The GCC aggregates available capital resources and required regulatory capital from the individual entities comprising the group, using a combination of (x) entity-level RBC amounts for U.S. insurance companies, (y) scalars to adjust available capital and capital requirements for entities not subject to other capital regimes, and (z) defined capital calculations for entities not subject to any regulatory capital requirement.[7]
- The FRB's "Building Block Approach" (BBA), adopted in 2023, and applicable to the small number of insurance groups (currently five) that own depository institutions.[8] Similar to the GCC, the BBA builds on the existing state-based RBC framework by adjusting and aggregating local legal entity capital requirements to determine group-wide available capital and required capital.

For purposes of the comparability assessment, the IAIS used a "Provisional AM" model released by the NAIC in 2023, which resembles the GCC but is unscaled – i.e., local capital requirements are set at a PCR (or equivalent) level without any further adjustment (all scalars are 100%) other than for double-counting.[9] The NAIC anticipates that the final AM (Final AM), which will be developed in connection with implementation of the AM as an outcome-equivalent method to the ICS, will include scalars. Various methodologies for determining such scalars are under consideration by the NAIC and the American Academy of Actuaries.

The IAIS indicates in the AM Report that it intends the implementation process for the Final AM to be "a means to address the remaining areas where the Provisional AM produces divergent outcomes to the ICS in specific circumstances" and that "[t]hese adjustments could help ensure convergence of outcomes with the ICS for U.S. life IAIGs …, while recognizing that the decision on the changes to be implemented is for U.S. supervisors to consider within the context of the U.S. supervisory system."

AM Comparability Assessment

The United States was the only jurisdiction in scope of the AM comparability assessment, and the AM Report indicates that its conclusions do not extend to the application of an AM in any other jurisdiction. The assessment compared outcomes for the Candidate ICS and the Provisional AM as applied to data collected from a volunteer group consisting of nine U.S. IAIGs (three life, six non-life)[10] and one U.S. non-life non-IAIG. The goal of the assessment was to determine whether the Provisional AM results in "comparable outcomes" to the ICS, with a focus on supervisory intervention, as the IAIS defines comparable outcomes to mean "that the AM would produce similar, but not necessarily identical, results over time that trigger supervisory action on group capital adequacy grounds."

The AM quantitative analysis focused on how required capital, available capital, surplus capital and solvency ratios react under various economic and financial conditions over the business cycle under both the Provisional AM and the Candidate ICS, using six sets of economic and financial market conditions, and including a sensitivity analysis. The IAIS assessed the overall quality and eligibility of capital resources allowed in the Provisional AM and the ICS using the five key principles applied to identify capital resources for purposes of the ICS: loss-absorbing capacity, level of subordination, availability to absorb losses, permanence and absence of encumbrances and mandatory servicing costs, and concluded that such quality and eligibility were similar under both regimes.

For U.S. non-life groups, the IAIS concluded that the overall level of prudence in the Provisional AM is at least equivalent to that of the ICS, as the Provisional AM generally results in a lower amount of available capital and a higher capital requirement compared to the ICS, particularly with respect to U.S. RBC factors applicable to underwriting risks. For U.S. life groups, the IAIS identified differences between the Provisional AM and the ICS in the valuation of insurance liabilities and the capital charge for interest rate risk. For both sets of groups, the IAIS noted that, in the more severe stress scenarios, available capital and solvency ratio tend to fall more rapidly under the Provisional AM than under the ICS, due to limits under U.S. RBC on the proportion of total available capital that may consist of financial instruments.

The IAIS also considered whether the Provisional AM and ICS results change similarly in response to economic and financial market cycles. The AM Report indicates that solvency ratio, required capital and available capital of U.S. non-life groups generally move in the same direction under the Provisional AM and the ICS. On the other hand, the AM Report identifies divergences in the direction and magnitude of the changes in solvency ratio, required capital and available capital between the Provisional AM and the ICS for certain U.S. life groups in certain scenarios, particularly in a low-yield environment.

The IAIS also considered whether the Provisional AM would trigger supervisory action on group capital adequacy grounds under similar conditions as the ICS over the course of the business cycle. The IAIS found the Provisional AM to be at least as prudent as the ICS for U.S. non-life groups. For U.S. life groups, however, the IAIS noted that solvency ratios under the Provisional AM are typically higher than under the ICS, and multiple times higher in certain scenarios (particularly in a low-yield environment), leading to the possibility that, in certain instances, a breach of the ICS would not be accompanied by a corresponding breach of the Provisional AM, "suggesting that there are instances where the Provisional AM may not be as prudent as the ICS."

Finally, the IAIS considered whether the Provisional AM and ICS are similarly transparent in terms of public disclosure and reporting to group-wide supervisors. The AM Report notes that, while ComFrame standards on supervisory reporting and public disclosure have not yet been developed, the NAIC's Provisional AM document covers both reporting to the group-wide supervisor and public disclosure, which provides evidence of a commitment to meet ComFrame public disclosure and supervisory reporting requirements.

Following the assessment, the IAIS concludes that "a US AM provides a basis for implementation of the ICS to produce comparable outcomes," but highlights two of the areas discussed above where "the Provisional AM produces divergent outcomes to the ICS in specific circumstances," both related to U.S. life IAIGs: (1) changes in interest rates potentially driving divergent movements in results between the Provisional AM and the ICS; and (2) the Provisional AM not always being as prudent as the ICS in specific circumstances with respect to the triggers for supervisory intervention on group capital adequacy grounds. The AM Report notes that "[i]n using the Final AM as its implementation of the ICS, the U.S. commits to addressing those areas in appropriate ways, which will be reviewed during the IAIS ICS implementation assessment process."

The AM Report concludes by noting that assessment of the U.S. implementation of the Final AM will proceed on the same timeline as ICS implementation assessments in other jurisdictions (self-assessment in 2026 and targeted jurisdictional assessments beginning in 2027), and will assess "whether the jurisdictional implementation at least meets the ICS (i.e., produces at least the same level of prudence as the ICS and similar triggers of supervisory intervention), whilst also focusing on the AM specificities."

As a consequence of the IAIS comparability assessment, U.S.-based IAIGs will not be expected to implement the "consolidated" ICS as a PCR. The NAIC has stated that the U.S. plans to implement the Final AM through the existing NAIC GCC, although it remains to be seen to what extent the Final AM to be used for purposes of the IAIS implementation assessments may be revised, as compared to the Provisional AM and the existing GCC, to reflect specific scalar methodologies and to address the "divergent outcomes" referenced in the AM Report.

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ENDNOTES

1 IAIS, *IAIS Executive Committee approves Insurance Capital Standard for adoption by IAIS members and concludes Aggregation Method comparability assessment*, November 14, 2024. *See also*, IAIS, *FAQ on the planned adoption and implementation of the Insurance Capital Standard and conclusion of the Aggregation Method comparability assessment*, published on November 14, 2024 (the FAQ will be periodically updated in response to frequently asked questions).

2 IAIS, *Report on the Aggregation Method Comparability Assessment*, November 14. 2024.

3 The IAIS defines PCR as a "solvency control level above which the supervisor does not intervene on capital adequacy grounds. IAIS, *Insurance Core Principle* (ICP) 17.4.

4 *See*, IAIS, *Register of Internationally Active Insurance Groups based on information publicly disclosed by group-wide supervisors*, October 30, 2024 (the Register is periodically updated by the IAIS).

5 *See*, Secretary of Treasury, Chair of the FRB, Director of the FIO, *The Impact of the International Insurance Capital Standard on Consumers and Markets in the United States*, November 2024. The report was submitted pursuant to section 211(c)(3) of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). Comments on the report are due by January 12, 2025.

6 *See*, IAIS, *Final Aggregation Method Comparability Assessment Criteria*, March 9, 2023. For additional information on this proposal, see our memorandum to clients: *IAIS Finalizes Criteria for Aggregation Method Comparability Assessment* (March 31, 2023).

7 Information on the GCC is *available at*: https://content.naic.org/cipr-topics/group-capital-calculation.

8 Board of Governors of the Federal Reserve System, *Federal Reserve Board finalizes a rule establishing capital requirements for insurers supervised by the Board* (Oct. 6, 2023). For additional information on this proposal, see our memorandum to clients: *Federal Reserve Adopts Regulatory Capital Framework for Insurance Depository Institution Holding Companies* (October 25, 2023).

9 *See*, NAIC, *Provisional AM for Use in the Comparability Assessment*, September 13, 2023.

10 These nine IAIGs represented all designated U.S.-based IAIGs as of the inception of the comparability assessment process (February 2023); three new IAIGs have been identified by U.S. group supervisors since that date and such groups were not included in the comparability assessment.

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