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IAIS Finalizes Criteria for Aggregation Method Comparability Assessment

IAIS Releases Comparability Criteria for Assessing Whether Aggregation Method Provides Comparable Outcomes to Insurance Capital Standard

SUMMARY

On March 9, 2023, the International Association of Insurance Supervisors (“IAIS”)¹ published the criteria (“Comparability Criteria”) that will be used by the IAIS to assess whether the Aggregation Method (“AM”) being developed by the United States provides comparable outcomes to the IAIS’s Insurance Capital Standard (“ICS”).²

If deemed comparable to the ICS, the AM approach to a group capital calculation being developed in the United States will be considered an “outcome-equivalent approach” for implementation of the ICS as a group-wide prescribed capital requirement (“PCR”). The AM differs from the ICS and other “consolidated” approaches to group capital because the AM relies on existing local capital requirement calculations at the level of a group’s various subsidiaries rather than on the creation of a single, standardized calculation at the consolidated group level. The AM achieves this by aggregating jurisdictional regulatory required capital and available capital (scaled to a uniform basis) to a single measure.

The Comparability Criteria will be used to assess whether the AM provides comparable outcomes to the ICS, in the context of the six “high-level principles” (“HLPs”) for comparability the IAIS adopted in 2021. The IAIS will begin this assessment in the third quarter of 2023 and is expected to publish a report on the outcome of the assessment in the third quarter of 2024.

BACKGROUND

The ICS is intended to be a group-wide, consolidated insurance capital standard for application to internationally active insurance groups (“IAIGs”) and is designed to enhance global convergence among group capital standards for insurers.³ On November 14, 2019, the IAIS adopted ICS Version 2.0,⁴ the implementation of which is being conducted in two phases: (1) a five-year “monitoring period” that began in January 2020, during which the “reference ICS,” which is based on a market-adjusted valuation approach, is being used for confidential reporting to group-wide supervisors (*i.e.*, national regulators) and discussion in supervisory colleges; and (2) at the conclusion of the monitoring period, implementation of ICS 2.0 as a PCR.⁵

In connection with its adoption of ICS 2.0 in November 2019, the IAIS agreed on a process and timeline for developing criteria to assess whether the AM provides comparable outcomes to the ICS. In March 2021, following public consultation, the IAIS agreed on a definition of comparable outcomes and six HLPs to guide the development of the comparability criteria.

The IAIS plans to collect data from the United States “and other interested jurisdictions” that will aid in the development of the AM,⁶ with the goal of being in a position to assess, by the end of the five-year monitoring period, “whether the AM provides comparable (*i.e.*, substantially the same (in the sense of the ultimate goal)) outcomes to the ICS.” If so assessed, the AM will be considered an “outcome-equivalent” approach for implementation of ICS as a PCR. The data will be collected from a representative sample of volunteer IAIGs (“Volunteer Groups”).

The National Association of Insurance Commissioners (“NAIC”), the Federal Insurance Office (“FIO”), the Board of Governors of the Federal Reserve and U.S. state insurance regulators—referred to as “Team USA”—have been critical of the ICS framework and have requested that the IAIS recognize the AM as an outcome-equivalent approach. Among other things, Team USA and members of the U.S. Congress have expressed concern that the market valuation approach typified in the ICS will be excessively volatile and may undermine the ability of U.S. insurers to offer certain types of annuities and life insurance and other long-term products.⁷

The NAIC has developed a group capital calculation (“GCC”) for use in insurance group solvency-monitoring activities for U.S. insurance groups. The GCC is a risk-based capital (“RBC”) aggregation approach (*i.e.*, a type of AM), whereby available capital resources and required regulatory capital are aggregated from the various individual entities comprising the group, including U.S. and non-U.S. entities. To aggregate entities whose capital requirements may differ from U.S. RBC, the GCC proposes to apply scalars to adjust available capital and capital requirements.⁸ In 2020, the NAIC adopted revisions to its insurance holding company system model act and regulations, as well as a set of GCC Instructions and GCC Template, for implementation of the GCC in the United States. The NAIC has proposed that provisions

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of the GCC-related amendments to the insurance holding company models will become accreditation standards effective as of January 1, 2026, which will require U.S. states to adopt significant elements of the amendments by January 1, 2026 to remain accredited by the NAIC.

The components of the final AM (e.g., choice of scalars, exact adjustments made and treatment of certain capital resources) to be used for purposes of the comparability assessment will not be known until the IAIS releases the 2023 AM data collection and related technical specifications.⁹ It remains unclear what the exact relationship between the final AM (if accepted as outcome-equivalent by the IAIS) and the GCC as implemented in the United States would be.¹⁰

COMPARABILITY CRITERIA

The Comparability Criteria indicate that the AM would be considered to produce comparable outcomes to the ICS if it “would produce similar, but not necessarily identical, results over time that trigger supervisory action on group capital adequacy grounds.” The comparability assessment will be conducted on the basis of six HLPs identified in the Comparability Criteria.

HLP 1: “AM and ICS results are significantly correlated in that they change similarly in response to changing economic and financial market conditions over the business cycle, not short-term market fluctuations, although the quantum of change may differ.”

The assessment of whether the results are significantly correlated will be conducted over the business cycle as a whole. The correlation analysis will be based on multiple points in time over the business cycle, and includes a sensitivity analysis (discussed below), intended to avoid “false indications due to short-term market fluctuations.” The sensitivity analysis will rely on previously submitted data to the extent possible, as well as data that is already planned to be submitted or publicly available.

For life business, three scenarios will be used to inform the analysis of correlation of results over the business cycle: 2020 pandemic, 2022 interest rate and inflation spike, and 2007-09 Global Financial Market Crisis scenario, as specified by the IAIS. If necessary, the IAIS could request an additional scenario, such as an “upward scenario.”

For non-life business, the three scenarios will be: 2020 pandemic, 2022 interest rate and inflation spike, and a scenario that captures specific changes to non-life insurance risks, such as a catastrophic event.

In order to inform the analysis, each Volunteer Group being assessed as part of the AM comparability exercise will provide, in addition to the AM and ICS results of the sensitivity analysis, a description of an economic and/or underwriting scenario that would cause: (1) AM capital resources to become less than the AM capital requirement at the group level, as well as the corresponding impact on the ICS; and (2) ICS capital resources to become less than the ICS capital requirement at the group level, as well as the corresponding impact on the AM.

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HLP 2: “Individual elements of a group solvency approach, *i.e.*, valuation, capital resources and capital requirement, will be analyzed; however, the decision on comparable outcomes will consider the elements in totality.”

The IAIS will assess whether (1) the AM captures the same underlying risks as the ICS, “even if this is achieved differently within the quantitative calculation of the group capital requirement,” and (2) the overall AM capital requirement and the ICS capital requirement “provide a similar level of solvency protection.”

The overall quality and eligibility of capital resources allowed in the AM must be similar to the ICS and will be assessed considering the five key principles identified for ICS capital resources: loss absorbing capacity, level of subordination, availability to absorb losses, permanence and absence of encumbrances, and mandatory servicing costs.

Under the relevant HLP2 criteria, prudence in one element of a group solvency approach (*i.e.*, valuation, capital resources and capital requirements) may be used to offset less prudence in another element. Moreover, the AM is expected under the Comparability Criteria to capture the same underlying risks as the ICS, such that the IAIS will analyze the AM to understand and determine how all risks covered in the ICS are captured in the AM calculation.¹¹ In addition, the analysis will include whether “the overall AM, which relies on underlying legal entity valuation and capital requirements, provides a similar level of solvency protection as the ICS.” The ICS has a target calibration of 99.5% Value at Risk (VaR) over a one-year time horizon; whereas the AM capital requirement is calculated as the aggregation of scaled risk-based legal entity capital requirements with a target calibration of at least a 0.5% probability of default.

Finally, the overall quality and eligibility of capital resources allowed in the AM must be similar to the ICS for the representative sample of Volunteer Groups. This will involve an analysis of: capital elements other than financial instruments that are recognized and treated under each method; deductions from ICS capital resources as compared to how the AM treats such items (which could include evaluation of non-admitted assets that have already been removed from the entity-level balance sheet under the AM); financial instruments recognized in the AM under the five key principles identified above for ICS capital resources; and capital composition limits between the two methods.

HLP 3: “The AM could be more but not less prudent than the ICS, which is being developed as a minimum standard.”

The HLP3 relevant criteria include whether the AM triggers supervisory action on group capital adequacy grounds under similar conditions over the business cycle as the ICS, and whether the level of solvency protection of the two methods is similar in totality.

For purposes of this analysis, the solvency ratios for individual IAIGs under both AM and ICS will be used to understand when the AM triggers supervisory action compared to the ICS. The analysis will consider

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movements in capital resources and capital requirements (as well as their difference, *i.e.*, excess capital) at different points in time to understand the drivers of the movements in solvency ratios.

HLP 4: “The AM and ICS use the same scope of the group, consistent with that set out in the IAIS’s Common Framework (ComFrame).” All entities in the scope of the ICS calculation must be captured in the AM calculation.

HLP 5: “A representative sample of volunteer groups, covering a diversity of business models, provide both ICS and AM data under various economic and financial market conditions over the business cycle.”

The sample of the Volunteer Groups providing both AM and ICS results must be representative of the business models, geography and risks of IAIGs headquartered in the United States “or other interested jurisdictions.” This will be determined separately for life and non-life operations, with composite groups being split between their life and non-life operations. The number of Volunteer Groups providing both AM and ICS data, and the overall scope and quality of the information that they provide, must be stable or increase during the monitoring period.

For purposes of the determination of representativeness, material geographical areas, as determined by the legal entity location, of U.S. (or other interested jurisdictions) IAIGs will be included in the representative sample. Relevant and sufficient data necessary to assess the comparability criteria are to be provided for both the ICS and AM data collections.

For life and non-life Volunteer Groups, representativeness will be determined as the ratio of total AM required capital of IAIGs participating in both the ICS and AM data collections to the total AM required capital of all U.S. (or other interested jurisdictions) IAIGs, with the minimum level of representativeness set at 80%. In addition, for U.S. non-life IAIGs, an approximation of ICS results derived from audited publicly available data may be used for representativeness.

HLP 6: “The AM and ICS are similarly transparent, in terms of facilitating understanding and comparability, within and across jurisdictions, of the group solvency position through public disclosure and reporting to group-wide supervisors.”

IAIG capital reporting to group-wide supervisors and public disclosure requirements as required under ComFrame will apply to AM. The IAIS comparability assessment will consider preparatory work that shows evidence of a commitment to meet ComFrame public disclosure and supervisory reporting requirements.

Next steps: The comparability assessment will be conducted using the reference ICS as a PCR, which will be part of the 2023 ICS data collection for the fourth year of the ICS monitoring period and will be publicly consulted on during the third quarter of 2023. The 2023 ICS and AM data collection packages (technical specifications, template and qualitative questionnaire) will be made publicly available before the start of the comparability assessment. The upcoming milestones of the comparability assessment project are:

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- 2023, Q3: Assessment of whether the AM provides comparable outcomes to the ICS begins
- 2024, Q2: Assessment of whether the AM provides comparable outcomes to the ICS ends
- 2024, Q3: Decision on whether the AM provides comparable outcomes to the ICS
- 2024, Q3: Publication of a report on the outcome of the assessment of whether the AM provides comparable outcomes to the ICS.

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ENDNOTES

- ¹ The IAIS, established in 1994, is a voluntary membership organization of insurance supervisors and regulators from more than 200 jurisdictions, constituting 97% of the world's insurance premiums. U.S. members of the IAIS include the U.S. Department of the Treasury's Federal Insurance Office, the National Association of Insurance Commissioners (NAIC), state insurance regulators and the Board of Governors of the Federal Reserve. Although the policy measures and financial reforms promulgated by the IAIS have no legal force unless enacted at the relevant jurisdictional level, the regulatory authorities of members' jurisdictions have committed to implement policy measures promulgated by the IAIS, taking into account specific market circumstances, and to undergo periodic self-assessments and peer reviews with respect to their implementation.
- ² IAIS, *Final Aggregation Method Comparability Assessment Criteria*, March 9, 2023, available, along with an Explanatory Note and supporting materials, at: <https://www.iaisweb.org/activities-topics/standard-setting/comparability-assessment/>.
- ³ Under the IAIS's Common Framework for the Supervision of Internationally Active Insurance Groups or "ComFrame" (adopted in November 2019), the group-wide supervisor is responsible for the identification of IAIGs, in cooperation with other involved supervisors, after considering whether a group meets both of the IAIG "internationally active" and "size" criteria: (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 USD 50 billion or total gross written premiums are at least USD 10 billion (in each case based on a three-year rolling average).
- ⁴ See, IAIS, *Level 1 Document for ICS Version 2.0 for the monitoring period*, November 19, 2019, available, along with other supporting materials relating to the ICS, at: <https://www.iaisweb.org/activities-topics/standard-setting/insurance-capital-standard/>. For further information, see our Client Memorandum, *IAIS—International Capital Standard, ComFrame, Holistic Framework for Systemic Risk in the Insurance Sector*, dated December 18, 2019, <https://www.sullcrom.com/iais-adopts-global-frameworks-for-insurance-supervision>.
- ⁵ 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.
- ⁶ There is no indication in the materials publicly issued by the IAIS that any jurisdiction other than the United States is an "interested jurisdiction" for purposes of the AM comparability exercise.
- ⁷ For example, on November 14, 2019, the FIO registered its official objection to the IAIS's advancement of ICS 2.0 into the monitoring period, noting that "U.S. insurers should not face pressure to participate in a reference ICS that is not expected to apply in the United States and does not fit [domestic] markets" and arguing that the "current form of the ICS could also risk limiting U.S. consumers' access to important long-term saving products." See, FIO, *Readout on the International Association of Insurance Supervisors Annual Meeting*, November 14, 2019, available at: <https://home.treasury.gov/news/press-releases/sm830>. In addition, in November 2019, a group of 30 senators signed a bipartisan letter to the U.S. Treasury Secretary raising concerns about the IAIS adoption of ICS, which is available at: <https://www.scott.senate.gov/download/11/12/19-letter-to-sec-mnuchin>.
- ⁸ Information on the GCC is available at: <https://content.naic.org/cipr-topics/group-capital-calculation>.
- ⁹ The 2022 AM Data Collection technical specifications described the calculation of a "Provisional AM" to serve as the default calculation while the AM is under development. For example, the Provisional AM used scalars of 100% (*i.e.*, it was unscaled). It remains to be seen what final scalars may be used for the final AM to be used in the comparability assessment.
- ¹⁰ According to the NAIC, "[w]hile influenced by the GCC and calculated in a similar manner, the AM will be more jurisdictionally agnostic, and perhaps simpler, than the GCC." NAIC, Center for Insurance Policy and Research, *Group Capital Calculation*, last updated August 8, 2022, available

ENDNOTES (CONTINUED)

at: <https://content.naic.org/cipr-topics/group-capital-calculation>. See also, NAIC, *NAIC Position Statement on Final IAIS Criteria to Assess Whether the AM Provides Comparable Outcomes to the ICS*, March 2023, available at: <https://content.naic.org/sites/default/files/inline-files/NAIC%20Position%20Statement%20on%20IAIS%20Criteria%20for%20AM%20Comparability.pdf>.

- ¹¹ The assessment of whether risks covered in the ICS are captured in the AM could be achieved through either an explicit risk charge, prudence embedded in valuation (*i.e.*, accounting conservatism) or other quantitative measures (*e.g.*, scalars).

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