American Academy of Actuaries
Essential Elements
Making complex public policy issues clear
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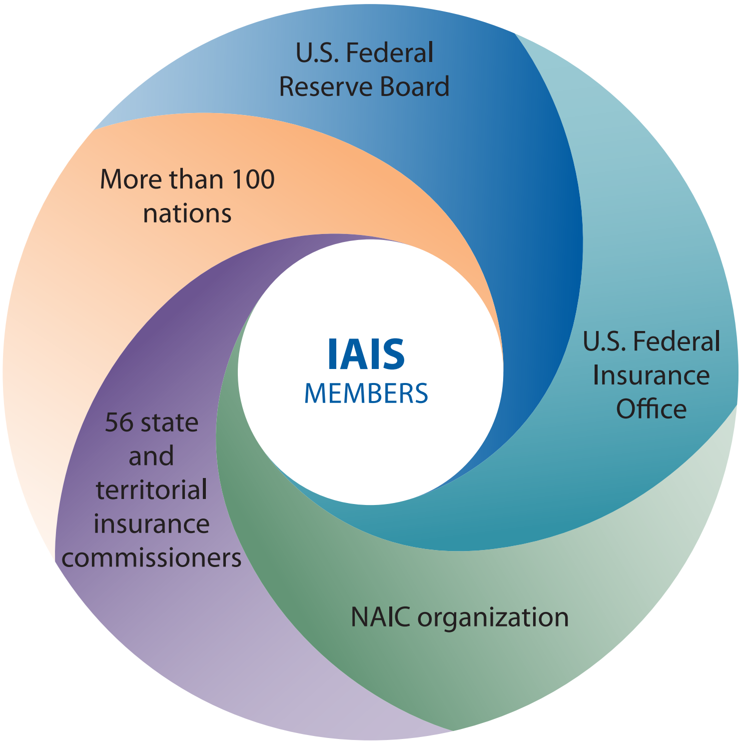
Insurance Capital Standards

New insurance solvency and capital standards intended to help prevent insurers from becoming too leveraged and risking insolvency are being developed by U.S. regulators and international standard setters. These proposed standards could have a profound effect on domestic and international insurers, which in turn could affect the price and availability of insurance products for businesses and consumers.

The National Association of Insurance Commissioners (NAIC) and the Federal Reserve Board (Fed) are developing new capital standards proposals for U.S. insurers. The International Association of Insurance Supervisors (IAIS) is developing solvency and capital standards for large multinational insurers, although its decisions would not be legally binding on U.S. companies.



For all domestic and international policymakers developing capital standards, the American Academy of Actuaries' Solvency Committee has developed a comprehensive set of principles to guide them. These include:

- Creating a group-solvency regime with clear regulatory purposes and goals.
- Establishing metrics for standards that are useful to all relevant parties.
- Promoting responsible risk management and encouraging risk-based regulation.
- Taking into consideration local jurisdictional environments.
- Making solvency standards compatible across accounting regimes.
- Minimizing pro-cyclical volatility.
- Presenting a realistic view of an insurance group's financial position and exposures to risk.
- Using internally consistent assumptions in capital or solvency models.
- Focusing on a total asset requirement to ensure insurers can meet obligations and capital is accessible in times of stress.
- Demonstrating that capital is accessible during times of stress.

Regulatory Tracks

Because there are several organizations and government entities individually developing new insurance capital standards, various proposals may not be reconcilable, which could create challenges for insurers to comply with multiple standards.

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IAIS

- Developed a basic capital requirement (BCR) framework for global systemically important insurers (G-SIIs) that measures their assets, and life and non-life insurance activities. The BCR that was finalized in 2014 will be privately reported by G-SIIs to groupwide supervisors in 2015.
- Creating an insurance capital standard (ICS) for G-SIIs and internationally active insurance groups (IAIGs). The ICS framework is expected to be completed in 2016, used for confidential reporting in 2017, and implemented in 2019. It is not intended to supplant the laws, regulations, or capital standards of local jurisdictions. The ICS is expected to replace the BCR and be further refined after its completion.
  - The draft ICS focuses on the overall solvency of a group and is not intended as an accounting standard or as a tool to measure or forecast earnings, unlike generally accepted accounting principles (GAAP) or the International Financial Reporting Standards (IFRS). As a result, it approaches valuation differently than the proposals being considered by the International Accounting Standards Board (IASB) for IFRS.
    - The IAIS is examining possible approaches for determining a comparable margin over current estimate (MOCE) to be included in the liability under ICS, such as the transfer value or prudence approaches.
    - The MOCE transfer value approach represents the additional compensation that a market participant requires to assume obligations.
    - The MOCE prudence concept is an adjustment to the liability value such that an entity can continue operating at a particular confidence interval or a margin that does not allow profits to be recognized at issue.
    - The IASB divides its risk margin into two pieces: the risk adjustment and the customer service margin, which is applicable only for long-duration business and designed to eliminate any gain at issue.
- Developing the higher loss absorbency (HLA) rule, which could require G-SIIs to hold up to 60 percent more capital than the BCR because of their systemic importance in the international financial system.

U.S. Federal Reserve Board

- Developing a new capital standard for domestic systemically important financial institutions (SIFIs). The Fed was given this authority by the Dodd-Frank Act.[1] The Insurance Capital Standards Clarification Act,[2] signed into law in December 2014, clarifies the Fed is not required to apply bank-based capital standards to insurers. Once finalized, the Fed intends to request public comments on its proposal.

NAIC

- Developing a proposal for group solvency and capital standards for U.S.-based insurance groups. The NAIC is examining risk-based capital plus, cash-flow, and hybrid approaches for its capital standards proposal.

1 Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law No: 111-203; 07/21/2010).
2 Public Law No: 113-279 (12/18/2014).

'ALPHABET SOUP'

Experts in the area of insurance capital standards use numerous acronyms to refer to groups, designations, and requirements. The most-used acronyms include:

BCR – basic capital requirement
Framework created by the IAIS that measures a G-SII's assets, and life and non-life insurance activities.

FSB – Financial Stability Board
Organization established by the G-20 after the 2008 financial crisis to address vulnerabilities in global financial system.

G-SII – global systemically important insurer
Designation by the FSB of a multinational insurance group that could harm the global financial system if it were to become insolvent and fail. U.S. G-SIIs are American International Group Inc., MetLife Inc., and Prudential Financial Inc.

HLA – higher loss absorbency
Additional capital requirement being developed by the IAIS for G-SIIs to reflect "their systemic importance in the international financial system."

IAIG – internationally active insurance group
Large international group with over $50 billion in assets, writing premiums in at least three jurisdictions, a 10 percent international premium threshold, and includes at least one sizeable insurance entity.

IAIS – International Association of Insurance Supervisors
International standards-setting organization tasked by the FSB to promote effective and globally consistent supervision of the insurance industry to maintain global financial stability.

ICS – insurance capital standard
A solvency framework under development at the IAIS that would apply minimum capital standards to all IAIGs.

MOCE – margin over current estimate
The difference between the valuation of technical provisions (as identified by the ICS) and the current estimate.[3] The MOCE "reflects the inherent uncertainty related to all relevant future cash flows that arise in fulfilling insurance obligations over the full time horizon thereof."[4] The IAIS is determining if this specific risk margin should be incorporated into the ICS valuation.

NAIC – National Association of Insurance Commissioners
U.S. standard-setting and regulatory support group composed of all 56 state and territorial insurance regulators.

SIFI – systemically important financial institution
Designation by the Financial Stability Oversight Council (FSOC) for U.S. firms whose collapse would pose a serious risk to the economy.

3 "Insurance Core Principle 14.7—Valuation," IAIS, 2011.
4 "Insurance Core Principle 14.9—Valuation," IAIS, 2011.