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Submitted for the Record

U.S. House Financial Services Subcommittee on Housing and Insurance Hearing
Entitled "The Impact of International Regulatory Standards
on the Competitiveness of U.S. Insurers, Part II"
November 18, 2014

Chairman Neugebauer, Ranking Member Capuano, and distinguished Members of the Subcommittee:

On behalf of the American Academy of Actuaries'[1] Solvency Committee, I appreciate the opportunity to provide this written testimony for your Subcommittee's November 18 hearing: "The Impact of International Regulatory Standards on the Competitiveness of U.S. Insurers, Part II." I would like to provide you and the members of the Housing and Insurance Subcommittee with input on certain key priorities and principles that the American Academy of Actuaries believes should be contemplated when considering and developing insurance group solvency and capital standards. We hope these principles will be helpful to the Subcommittee as it engages with state, federal, and global insurance regulators and legislators on these issues.

Any international group solvency or capital standards developed by entities such as the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS) likely would have a profound effect on many domestic and international insurers. That is why proposed international standards from the IAIS must be created in a careful, transparent, and meaningful manner. Failure to do so would risk undermining the ability of U.S. insurers to operate effectively and efficiently, and could negatively impact the financial stability of U.S. insurance regulation and the insurance industry.

As U.S. legislators and regulators continue to discuss and develop insurance group capital and solvency standards, the American Academy of Actuaries offers its support in engaging and

[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.

shaping this challenging area of public policy. To this end, we offer the following principles for consideration as the House Financial Services Housing and Insurance Subcommittee develops its perspectives concerning the elements of U.S. insurance group capital and solvency proposals:

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, as well as 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. The actuarial functions are critical in the risk management process and their role should be clearly defined, as it is in the U.S. reserving and solvency framework. Actuaries can and should identify where factor-based systems may miss key emerging risks, set reasonable boundaries around more subjective 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 operates, 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 and harmful consequences on regulated 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 stress, to the entity facing the risk for which the capital is required.

The Academy has made similar recommendations to the Federal Insurance Office within the Department of Treasury, the Federal Reserve Board, and state legislators and regulators.

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Thank you for this opportunity to provide our views on the key principles that should help in the development of insurance group solvency and capital standards. Actuaries have worked for decades with insurance and other financial sector regulators to develop prudent rules that address insurer solvency, including capital requirements. Actuaries' involvement has been critical in the development and evaluation of U.S. insurance regulations, and we believe that actuarial expertise will contribute greatly to the creation of international insurance standards. The American Academy of Actuaries looks forward to assisting the Subcommittee as it reviews global insurance standards and their potential implications for domestically active insurers. 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.