



The Insurance Policy Advisory Committee (IPAC)

Record of Inaugural Meeting

November 4, 2019

Washington, District of Columbia

Welcome and Discussion of Mission

Federal Reserve Board (the Board) Vice Chair for Supervision Randal K. Quarles opened the inaugural IPAC meeting, welcomed members, and thanked them for their public service. He said the IPAC's purpose is to advise the Board on insurance matters. The Board has several different roles in insurance. Congress has mandated that the Board regulate and supervise holding companies of certain depository institutions, including those with insurance operations. Additionally, the Board's responsibilities regarding financial stability can involve insurance, and the Board participates at the International Association of Insurance Supervisors (IAIS) along with U.S. Treasury Department's Federal Insurance Office, the National Association of Insurance Commissioners, and the state insurance supervisors.

1. **Building Block Approach (BBA):** *What is BBA? What areas of the BBA Notice of Proposed Rulemaking (NPR) have generated discussion?*

Overview

Board staff member introduced the topic and highlighted a few aspects of the proposed rule that stakeholders have wished to discuss recently. IPAC members expressed comments on the following areas of the BBA NPR.

Scaling

Several IPAC members commented on the Board's white paper on translating capital requirements between different regulatory frameworks (scaling). This paper described a method for scaling based on estimated probability of default (PD) based on an analysis of advantages and disadvantages of different scaling methodologies. While no IPAC member opposed or criticized scaling based on PD, some IPAC members had questions about the implementation of the PD approach domestically and how the PD approach could be used internationally.

Two IPAC members asked questions about the definition of "default" used in the NPR. IPAC members were interested in the treatment of insurers that experience stress without being formally seized by regulators. Board staff explained how default was defined when parameterizing the NPR. In addition to insurers that are seized by regulators, insurers were deemed to default when they ceased writing new business and had weak financial position. This aligns with the Board's function as a going-concern regulator and captures some, but not all, "walking dead" insurers. Based on an analysis of losses on defaults in banking and insurance, staff found the default definitions reasonably comparable across sectors, and staff welcomed comments on the approach and potential alternative definitions.

Other IPAC members asked about the data set and which companies were included. One IPAC member asked if the Board's analysis included savings and loan institutions (S&Ls). Board staff confirmed that S&Ls were included. An IPAC member said that this was appropriate given the defaults of some S&Ls during the financial crisis. Another IPAC member asked how different insurance lines of business were treated. Staff explained that certain insurers, such as monoline medical malpractice insurers, were excluded because they differ from the relevant population. An analysis of default differences between property-and-casualty carriers and life carriers did

not reveal statistically significant differences. Consequently, the NPR combines these groups of companies.

One member asked how a stress event would affect the scaling analysis and commented that the parameters ideally wouldn't be overly influenced by a stress event. Staff explained that it had conducted extensive testing, including sensitivity testing the exclusion of certain data and the performance of the model with out of sample data. Based on this testing, staff found the parameters appear robust if the parameterization takes place across an entire business cycle because bank defaults are cyclical.

IPAC members discussed the scaling of international insurance capital frameworks. One IPAC member commented that the PD approach made intuitive sense and should be used internationally. The IPAC member suggested using ratings as a proxy for defaults given the lack of international default data. Another IPAC member asked if the NPR was flexible enough to allow using other approaches internationally. Staff explained that while legal restrictions could limit the Federal Reserve's ability to use ratings, the NPR contemplates using other approaches internationally and specifies a provisional scaling methodology for international insurance frameworks.

Captives and the Adjustment for Permitted and Prescribed Practices

IPAC members expressed opposing views on the proposed treatment of captive reinsurance companies and the related proposed adjustments to remove the impacts of grandfathering, permitted accounting practices, and prescribed accounting practices. One IPAC member expressed concern that significant adjustments may undermine the rationale for an aggregation approach. Another IPAC member described these adjustments as "cherry picking" from different regulatory frameworks. Three IPAC members responded that they viewed the proposal as appropriately balancing deference to different frameworks against the benefits of comparability.

IPAC members raised two different technical issues with proposed adjustments to remove the impacts of grandfathering, permitted accounting practices, and prescribed accounting practices. One member said that revisions to the proposal to eliminate existing grandfathering might be needed. Under the NPR, the removal of grandfathering would have required principles-based reserving (PBR) to be applied to some business. That business was often ceded to captive reinsurance companies, that has been exempted in state rules. The IPAC member commented that PBR would be difficult to apply retroactively and that some changes may be necessary. Another IPAC member commented that some permitted practices result from the lack of clarity in the existing accounting rules. Board staff requested any additional information and data that could be provided on these technical issues.

IPAC members also asked questions of Board staff on this issue. One question related to the expected impact on ratings from the Board's proposed treatment of captives. Board staff explained that most rating agencies have their own methodology to assess capital and that Standard and Poor's methodology already treats captives similarly to the Board's NPR. Thus, Board staff did not expect a significant ratings impact. Another asked if the Board was open to considering other approaches. Staff explained the Board's rulemaking process and that all comments would be considered. Staff also explained that under the Administrative Procedures Act, large changes to the proposal may require issuing a further notice of proposed rulemaking for comment before finalization.

Buffer

Multiple IPAC members asked questions about the proposed capital conservation buffer and its proposed calibration relative to the proposed minimum requirement. Board staff explained that the buffer was designed to achieve a level-playing field among financial institutions. It was calibrated by translating the buffer applied to other depository institution holding companies to the BBA's scale. One IPAC member described the purpose of the buffer for depository institution holding companies and how it increases their resiliency to losses. Two IPAC members expressed support for consistency in terms of the stringency of requirements between different depository institution holding companies. Two IPAC members suggested internal models as an alternative way to calibrate the buffer.

One IPAC member asked how the buffer would change over time and in response to changes to the buffer applied to other depository institution holding companies. Board staff explained that this would need to be considered in future rulemakings, but that certain changes to the generally applicable buffer would automatically apply to supervised insurance companies through the operation of the proposed cross references.

Capital Instruments

IPAC members discussed the BBA's proposed requirement for all capital instruments to meet the same requirements for loss absorbance as the capital instruments of other depository institution holding companies. One IPAC member noted the international implications of the NPR. This IPAC member said that while nonqualifying instruments are not material in the Board's currently supervised population, the issue is material internationally. The Board's proposal could further isolate IAIS members that advocate for differing treatments. Another IPAC member commented that there was little reason for the criteria to differ between sectors, but that the rating agencies do use different notching between operating company and holding company ratings for insurers and banks.

IPAC members also commented on the implications for mutual insurers, which cannot issue common equity. One IPAC member asked if there were consideration of how the NPR would work under stress. Staff responded that consideration of this issue had resulted in the limitation of some forms of capital being expressed as a percentage of required capital, which is less volatile than available capital. Another IPAC member agreed with expressing the limit in terms of required capital, but noted that this also varies, particularly in response to reinsurance transactions.

Compliance with the Collins Amendment to the Dodd-Frank Act

Two IPAC members criticized the proposed approach to achieving compliance with the Collins Amendment. After confirming that the separate Collins Amendment calculation would also be a binding constraint, these IPAC members commented that this separate calculation would prioritize legal form over substance, be inconsistent with Congressional intent, and dissuade the combination of banking and insurance. They suggested that no separate calculation appears to be necessary given that the Board's scaling analysis demonstrates that the BBA is "not less than" the bank capital requirements, as required by the law.

2. **Insurance Capital Standard (ICS):** *What are current ICS issues being considered internationally? What feedback do IPAC members have on those issues?*

Overview

Federal Reserve staff introduced issues open for consideration on the ICS and asked for feedback. IPAC members commented on the ICS reference method, the assessment of the

comparability of the aggregation method, and disclosure of ICS ratios during the planned five-year monitoring period.

ICS Reference Method

At the start of the discussion, IPAC members asked several questions of Board staff. IPAC members inquired about the status of negotiations and Board staff's expectations for upcoming meetings in Abu Dhabi and the monitoring period. Board staff responded that U.S. positions had not changed significantly since the U.S. Treasury's stakeholder meeting. Staff said the Abu Dhabi meeting would not resolve all issues. While some issues may be resolved, negotiations on others will likely persist. Staff said that the process for changing the reference ICS during the monitoring period is currently being negotiated. Several IPAC members suggested that making changes to the reference ICS would be important during the monitoring period. One IPAC member agreed with correcting significant flaws but also expressed that preserving this ability may only be a delay and should not be a priority unless specific desired changes have been identified.

IPAC members commented critically on the ICS reference method. Specifically, IPAC members discussed the current reference method's volatility. Multiple IPAC members also commented that ICS results currently lack meaning. Several IPAC members assessed the methodology to be unfit for adoption. While these members expressed a preference for delaying adoption or rebranding the reference method to clarify the significance of open issues, a majority of them acknowledged that such a change might not be possible due to prior agreements and the positions of other IAIS members.

Several IPAC members suggested working to improve the reference method during the monitoring period. One suggested making changes so that the approach could coexist with long-term products. Another suggested arguing that different factors need to be considered for better consistency of the market-based approach with actual market data on U.S. transactions.

Reporting and Disclosure

Several IPAC members expressed concern that issuers may need to disclose ICS ratios publicly during the monitoring period. One IPAC member noted that issuer disclosure standards are higher in the United States than in other jurisdictions. Material information must be disclosed, and security analysts might deem this information material due to a desire for a summary of group capitalization. Additionally, the disclosure of ICS results by certain highly capitalized companies could lead to a separating equilibrium where all companies have an incentive to disclose their ICS ratios. IPAC members suggested ways to avoid this outcome. One IPAC member suggested that the SEC could issue a no-action letter or the IAIS could state that investors would be unwise to rely on the ICS. On the later suggestion, another IPAC member suggested the IAIS emphasize that further changes to the standard are likely. This makes information on the organizations' current position on the reference method less important to investors. Board staff commented that the IAIS would not be able to prevent voluntary disclosure, but that Board staff would explore the other suggestions.

IPAC members also expressed reservations about reporting to supervisors. One IPAC member said this disclosure could influence the supervisory actions of any supervisors that prefer market value accounting. Another IPAC member noted the burden of calculating the ICS ratio. Board staff noted that the purpose of the monitoring period is to obtain information about the operation of the ICS rather than information about firms. IAIS says supervisory actions will not be taken in response to reported information, as ICS is not yet implemented during the monitoring period.

Comparability

IPAC members discussed the comparability of the aggregation method and the ICS reference method. Two IPAC members commented that, despite the Kuala Lumpur agreement to assess the aggregation method against the reference method, the methods are inherently not comparable. One IPAC member disagreed and another responded that the methods could be comparable if the reference method were improved.

Several IPAC members suggested comparing the aggregation method against a reference objective rather than a reference method. Multiple IPAC members mentioned timely intervention as a potential reference objective. Several IPAC members also suggested other factors that could be considered in an assessment. Factors mentioned included the U.S. system's enhanced governance over liability estimates and visibility into fungibility. One IPAC member commented that the stability of the U.S. system could be an advantage because it prevents capital releases during favorable periods.

Two IPAC members commented that the definition of comparability also should be applied to different countries' implementations of the ICS. One IPAC member noted that it can be hard to compare IFRS accounting across jurisdictions. Another IPAC member analogized captive reinsurance companies within the United States to the use of internal models to determine required capital under Solvency II. Both of these make it difficult to compare results within a regulatory framework.

3. IPAC Governance: *Given the inaugural nature of this meeting, what administrative items and governance does IPAC wish to discuss? What is the Federal Reserve's role in the supervision of insurance companies?*

Administration and Statutory Mandate

Board staff gave a presentation on the administration of the IPAC and the roles and responsibilities of the Board with regard to insurance. They discussed the IPAC's statutory mandate from the Economic Growth, Regulatory Relief and Consumer Protection Act and how the Board implemented this mandate in the IPAC's charter. IPAC members will serve three-year terms, except initially, when terms will be staggered. IPAC members are eligible for re-appointment. The charter also creates a role for an IPAC Chair, who is elected by a majority of IPAC members voting.

Additional Administration

One IPAC member mentioned potential IPAC working groups, but no decision was reached.

To allow for candid discussions, the IPAC adopted the Chatham House Rule's prohibition on public attribution of remarks.

IPAC Chair nominations and election

IPAC members voted to elect a chair. A majority of voting members elected Julie McPeak as IPAC Chair.

2020 IPAC Meetings

The IPAC discussed future meetings. Board staff recommended holding meetings during the week prior to the IAIS's Annual General Meeting and mid-year committee meetings. While international negotiations and decisions occur year round, Board staff said that these are typically the IAIS's most important meetings. During the week prior, the key issues for discussion and

decision are known. IPAC members agreed with this recommendation. Board staff gave tentative dates for the 2020 meetings and committed to following up with calendar invitations.

Several IPAC members additionally recommended that the IPAC hold a third meeting in 2020 focused on the BBA. Board staff agreed to follow up with the IPAC Chair on potential dates for this third meeting.

4. Additional Matters: *What other insurance issues were discussed or presented at this meeting?*

IAIS Holistic Framework

Board staff presented on the IAIS Holistic Framework, which the IAIS plans to adopt in Abu Dhabi. Two IPAC members supported the Holistic Framework's direction of travel towards focusing on activities and away from designating particular entities as systemically risky. Two members also commented that there will be need for increased monitoring under this new approach with good macroprudential data to allow examining issues like volatility in the repurchase agreement market. One IPAC member suggested better dialog between regulators and the insurance industry on identifying systemic risk.

ComFrame

Board staff introduced the topic of ComFrame, which the IAIS also plans to adopt in Abu Dhabi. One IPAC member highlighted that currently it is unclear if supervisors needed direct power over a group's holding company or whether indirect power through the operating companies would be sufficient.