

International Capital Standard, Holistic Framework, Cyber Insurance Highlight NAIC International Insurance Forum in D.C

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On May 13–14, 2019, the National Association of Insurance Commissioners (NAIC) hosted its annual International Insurance Forum in Washington, D.C. Highlights of the event included remarks from U.S. Department of the Treasury (Treasury) Secretary Steven Mnuchin; NAIC President and Superintendent of the Maine Bureau of Insurance Eric Cioppa; and International Association of Insurance Supervisors (IAIS) Secretary General Jonathan Dixon. The event was moderated by NAIC International Insurance Relations (G) Committee Chair Julie McPeak, who made her own headlines by announcing that she would step down as Commissioner of the Tennessee Department of Commerce and Insurance, effective June 14.

Significant statements or discussions arising during the Forum are summarized below:

IAIS International Capital Standard

Treasury Secretary Mnuchin

Secretary Mnuchin opened by renewing his commitment to the U.S. system of state-based insurance regulation and highlighting the important role of Treasury and the Federal Insurance Office with respect to domestic and international insurance matters. Regarding the work of the IAIS on an International Capital Standard (ICS), Secretary Mnuchin urged U.S. representatives to advocate strongly and collectively for development of international standards that reflect the U.S. regulatory structure. To this end, the Secretary noted his concerns about the development of the ICS.

In particular, the Secretary highlighted concerns about the following:

- *The ICS market valuation approach:* The current ideology regarding market valuation could have negative effects on the ability of insurers to provide long-term savings products. Treasury recommends that the IAIS reconsider how to appropriately account for long-term savings products in the ICS.
- *Confidentiality and the ICS timeline:* The November 2019 reference ICS timeline may not be sufficient. Further revisions will be required. The IAIS also needs to develop a process that ensures appropriate confidentiality in light of the continued revisions.
- *ICS implementation in the United States:* The IAIS must recognize and accommodate approaches taken by various jurisdictions around the world, including those in the United States. Treasury is working with the NAIC, Federal Reserve and other members of the IAIS to develop the criteria and process by which the U.S. approach to group capital may be deemed “outcome equivalent.”

Secretary Mnuchin’s remarks come at a time when Treasury is increasingly concerned about feasibility of implementing ICS in the United States. Treasury first signified a change in direction in a [2017 Report on Asset Management and Insurance](#) when, among other things, the Department noted that the IAIS “should postpone ICS Version 2.0 until a later date to allow further consultation with IAIS members and stakeholders on the development of an ICS that is implementable in all major insurance markets.” The Secretary’s remarks are significant, however, because the IAIS is nearing a November 2019 deadline for the ICS monitoring period: if U.S. authorities were to withdraw from ICS negotiations altogether, it would almost certainly destroy chances of a harmonized international capital standard in the near term.

NAIC President Cioppa

Superintendent Cioppa followed Secretary Mnuchin’s address by echoing Mnuchin’s concerns. Cioppa emphasized the challenges the ICS faces between now and the November 2019 deadline. While he did not take an affirmative stance on ICS, he *quoted* U.S. insurance stakeholders who contended, among other things, that “the ICS is currently not fit for purpose; with many believing that no amount of technical tweaks can address the fatal design flaws.” Cioppa also stated that “with the ICS, we seem to be going into the monitoring period with the delusion that we have reached the pinnacle of capital solvency evaluation,” while noting before and after that the ICS is not – and will never be – perfect.

U.S. Senate Letter to Fed Vice Chair Quarles

Although no sitting member of the Senate was in attendance at the Forum, the upper body made its presence felt by publishing a letter to Fed Vice Chairman Quarles on the opening day of the Forum. [The letter](#), which was signed by 42 members of the Senate, commended the Vice Chairman's [January 9 remarks](#) to the ACLI in Naples, Florida, where he said that the U.S. insurance regulatory system should be "deemed comparable to the ICS." The letter goes on to "question the need for an ICS" altogether.

Perhaps most significant, however, is that the letter requests that the Financial Stability Board (FSB) "publicly state that a global capital standard for insurers is not required." The FSB is the international body charged with monitoring the global financial system. It is chaired by Mr. Quarles. Any statement by Mr. Quarles to such an effect in his role as FSB Chair would wield substantial pressure on the IAIS to accommodate the states' approach to group capital.

IAIS Secretary General Dixon's Response

The following day, IAIS Secretary General Jonathan Dixon sat on a panel to discuss the IAIS' holistic framework. Despite the purported subject, Mr. Dixon was bombarded with ICS questions from the audience, including one from NAIC CEO Mike Consedine. Although reluctant to discuss ICS at first, Mr. Dixon ultimately provided his reaction to the statements from Secretary Mnuchin, Congress, and Superintendent Cioppa.

Mr. Dixon conceded that the regulatory framework for ICS must be well designed or else the framework itself may be a contributor to systemic risk. However, he downplayed the issue as one that will be resolved when the ICS is further assessed in the coming years. Mr. Dixon agreed that the IAIS needs to consider the effect of the ICS on long-term products and concluded that the IAIS needs to continue to consider the monitoring period, design, comparable outcomes, and the proper balance of a principles-based versus prescriptive regime. He also conceded that a prescriptive ICS runs a significant risk of not being implemented.

Nevertheless, Mr. Dixon concluded that the IAIS is making considerable progress on the ICS workstream, and that confidentiality issues prevented IAIS members from discussing specific progress with insurance industry stakeholders. He expressed confidence that the IAIS will find a way forward by this November.

IAIS Holistic Framework

Secretary Mnuchin also touched on the work of the IAIS as it relates to its holistic framework. He stated that Treasury supports shifting the focus of systemic risk analysis away from individual insurance entities and toward specific activities. He also highlighted the domestic work Treasury and the Financial Stability Oversight Council are doing regarding an activities-based approach to the evaluation of systemic risk.

The following day, Mr. Dixon discussed progress the IAIS is making on the holistic

framework and a timeline for completion. In November 2018, the IAIS published for public consultation a proposal for a holistic framework for addressing systemic risk. Such an approach would recognize that systemic risk may arise from both the collective activities/exposures of insurers at a sector-wide level (the proposed “activities-based” assessment) as well as from the distress or disorderly failure of individual insurers (the current “entity-based” or “G-SII” assessment).

In general, the holistic framework provides for (1) enhanced policy measures around risk management that are built into ComFrame and the IAIS Insurance Core Principles and a number of regulatory tools in addition to capital requirements; (2) continuation of IAIS supervision of 50 insurers and continual consideration of whether the holistic framework measures work as they should; (3) supervisor-to-supervisor discussions (e.g., supervisory colleges) that can respond to global challenges; and (4) proportionality (which, Mr. Dixon conceded, makes the framework’s development more challenging).

As for a timeline, Mr. Dixon stated that the IAIS is currently reviewing all stakeholder comments that were due in January and soon will consult with the Financial Stability Board (FSB). The goal of the IAIS is to adopt the framework by November 2019, at which time the IAIS intends to tell the FSB that it should suspend the G-SII framework (the IAIS has already represented to the FSB that the holistic framework is a better approach to mitigating systemic risk). Assuming this is successful, the IAIS will implement the holistic framework in 2020 and it will be evaluated by the FSB in 2022. If approved, the framework will entirely replace the G-SII framework.

Cyber Insurance

Mr. Gareth Truran (Head of London Market Supervision, PRA Insurance Directorate, Bank of England) discussed the growing cyber insurance market for underwriters and buyers as a panelist on a cyber insurance regulation panel. His discussion primarily focused on the PRA’s July 2017 Supervisory Statement (SS) 4/17 “Cyber insurance underwriting risk” and subsequent surveys on the same. Mr. Truran also touched on the PRA’s concern that cyber insurance could pose a threat to one or more insurer’s solvency.

Regarding SS 4/17, Mr. Truran explained that there were three key areas where the PRA believes “firms can do more to ensure the prudent management of cyber risk exposures.”

First, survey results indicated that most firms thought a number of traditional lines of business have considerable exposure to non-affirmative cyber risk (i.e., “silent cyber”). Here, the market needs to get to a stage where the silent cyber issue is capped, and regulators need to work together to build a common understanding of what is included and what is not included in policies *vis a vis* silent cyber: There are some lines where there is a clear demarcation where cyber does / does not exist and some where there is no such demarcation. Mr. Truran noted that the PRA has set a goal of providing greater clarity on this point by the end of 2019.

Second, survey results indicated that insurer boards of directors need to set a clear strategy for their appetite for cyber risk. While firms acknowledged the necessity of

having formalized risk appetites and a board-agreed strategy for both affirmative and non-affirmative cyber risk, survey responses indicated that progress has been varied and work has primarily appeared to focus on affirmative cyber risk. Mr. Truran indicated that there is scope for firms to make greater progress here.

Finally, survey results indicated that underwriters need help with how to prudently write the cyber risk. Although firms recognized the need to develop their knowledge further, due to the unique and evolving nature of cyber risk. In achieving this, firms acknowledged the input that can be provided by the Chief Information Security Officer or other existing technology expertise in the firm, they need to implement procedures to do so.

For its part, the London Market is actively contemplating how best to address the PRA's concerns. The International Underwriters Association (IUA), for example, has developed two cyber loss exclusion clauses ([Absolute Exclusion](#) and [Limited Exclusion](#)) that were drafted in order to assist with respect to the PRA's expectations. According to the IUA, the clauses also may be used as a reference point for insurers providing non-standalone cyber coverage, and, through the development of class-specific write-backs, allow insurers to explicitly state the extent of coverage provided for any Cyber Loss.

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