Session 2: Regulation of Insurers´ Investments and Solvency

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U.S. Risk-Based Solvency System

- In the 1990's, following a number of insolvencies in the U.S. in the 80's, the NAIC and state insurance supervisors implemented a risk-based capital standard.

- Prior to that time, regulators generally used fixed capital standards as a primary tool for monitoring the financial solvency of insurance companies – but fixed minimum capital requirements were largely based on state statutes and varied widely among the states.

RBC Formulas

- The RBC formulas are made up of components that represent the primary risks associated to that specific line of business. The following risks are included in each of the formulas:

  - **Asset risk**—is the risk associated with investments held by the insurer. This includes the possibility of default of principal and interest or fluctuation in fair value.
  - **Insurance (underwriting) risk**—is the risk of underestimating liabilities from business already written or inadequately pricing business to be written in the coming year.
  - **Insurance Affiliates and Misc. Other Risk** – is the risk from declining value of insurance subsidiaries as well as risk from off-balance sheet and other misc. accounts.

- The RBC formulas are maintained and updated on an annual basis. The Capital Adequacy Task Force has procedures in place for ongoing updates and monitoring of potential needed changes.

ORSA in the U.S.

- The U.S. ORSA came about following the 2008 financial crisis as regulators re-evaluated our RBC regime.

- **The ORSA applies to any individual U.S. insurer that writes more than $500 million of annual direct written and assumed premium, and/or insurance groups that collectively write more than $1 billion of annual direct written and assumed premium.**

- A majority of states have formally enacted NAIC Model law #505 (ORSA Law), which was added as an NAIC accreditation standard in 2017, meaning if states wish to be accredited by their peers, they must have passed the ORSA Law.

Challenges to the U.S. Regime

- Some challenges to our Risk-Based Solvency Regime include:
  - Insurance products are ever changing; and
  - The limited experience data available to address emerging potential risks.
- Notably, though, innovation in investments is also a challenge, as regulators work to keep the formulas generic and easily understandable while addressing the risks associated to the investments and limited experience data to evaluate these investments.

Alternative Investments

- At the NAIC, we capture Alternative Investments in our financial reporting annual statement in "Schedule BA."

- At year-end 2022, alternative assets remain a significant Asset Class among insurers, along with bonds, common stocks, and mortgages. Total Schedule BA exposure is $534B or about 6.6% of invested assets.

- These numbers have been gradually increasing over the years. For example, at year-end 2017, Schedule BA represented 5.5% of invested assets.

Breakdown of Alt. Investment Statistics

- As noted, insurers have about 6.6% of total assets in Schedule BA. Looking just at private equity, hedge funds, and real estate joint ventures, 2022 exposure was about $200B or 2.5% of invested assets broken down as follows:
  - Private equity, 1.2% of invested assets
  - Hedge funds, 1.2% of invested assets
  - Real estate joint ventures, 0.4% of invested assets
  - Direct real estate, which we do not consider alternative, is only 0.5% of invested assets.
- Life has about two-thirds of the total Schedule BA exposure; and
- Non-life about one-third.

Alt. Investments and Regulatory Action

- At this time, while we are not incredibly concerned that there is a large systemic risk arising from these investments, concerns regarding liquidity risk with these investments may be heightened compared to the more traditional asset types.

- Valuation and the lack of a liquid market for most of these investments gives rise to heightened monitoring.

- NAIC will be updating general guidance as needed.

New Ownership Models and Other "Risky" Behaviors

- PE ownership model is a business model that has existed for many years, and supervisors are continuing to monitor it as it becomes a wider trend.

- Due the recent increase in private equity (PE) owned insurers, complex organizational structures, and complex investments, state insurance supervisors are reviewing existing guidance and considering updates and/or new requirements to enhance their ability to assess and address riskier activities associated with these business models.

- State insurance regulators have developed a list of 13 considerations to formalize the review of existing guidance and consider updates and/or new requirements, including:

  - Operational, Governance and Market Conduct Practices;
  - Identifying Related Party-Originated Investments (Including Structured Securities;
  - Privately Structured Securities; and
  - Pension Risk Transfer (PRT) Business Supported by Complex Investments, among others.

Questions?