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# The Case For An International Capital Standard

September 2015

# Executive Summary

This presentation discusses new regulatory standards that the International Association of Insurance Supervisors (IAIS) is developing that will create a harmonized global framework for Internationally Active Insurance Groups (IAIGs). In an increasingly interconnected world economy, this presentation makes the case for international capital standards (ICS) for IAIGs.

- **New IAIS capital standards will not impact current U.S. regulation of insurers (SIFI or Dodd Frank) or domestic insurers.** An ICS would only impact 50-60 IAIGs, with no interaction with U.S. oversight of insurers in the vast majority of cases.
- **Globalization, for U.S. businesses large and small, is a reality. These businesses want global coverage to meet their new needs**. 50% percent of revenue from S&P 500 corporations comes from abroad. 98% of U.S. exporters were small businesses in 2013.
- **Unfortunately, the current regulatory climate for global insurers is fragmented, raising costs for policyholders.** Regulations, requirements, and capital standards vary across jurisdictions, trapping capital and raising the costs of doing business.
- **A globally consistent capital framework assessed at the group level would reduce these costs, allowing policyholders to operate with greater peace of mind.** Harmonized capital standards would reduce high barrier-to-entry costs and increase competition.
- **As a standard-setting body with strong U.S. representation, the IAIS is well positioned to create a new global capital framework.** As a standard setting body, the IAIS can only draft standards. Individual states would have to adopt them for their respective states.

# International Regulatory Harmonization Does Not Impact SIFI Designations Nor The Authority Of The Fed Or The Individual States

**International regulatory harmonization and capital standards do not impact:**

- **SIFI Designations And Their Associated Capital Requirements**: Zurich is not a designated SIFI by FSOC or the FSB. We do not believe traditional insurance is risky. Our concern lies not with *heightened* capital standards associated with SIFI designations, but with *harmonizing* capital standards for globally active insurance groups.

- **Federal Reserve Oversight Of Insurers Under Dodd-Frank**: Under Dodd-Frank, the Federal Reserve now has oversight of insurance holding companies that own an insured bank or thrift or those designated by FSOC. Many of these insurance groups are not internationally active insurance groups and are not expected to be subject to international capital standards.

- **Purely Domestic Insurance Groups**: No purely domestic insurance group would be subject to international capital standards unless the states chose to adopt them. The international capital standard is intended solely for internationally active insurance groups, of which roughly 10+ are in the U.S. out of a total of nearly 7,000 insurers, or less than 1 percent.

**This presentation addresses international capital standards for roughly 50 internationally active insurance groups across the globe, of which roughly 10-15 are based in the U.S. These capital standards would have to be accepted by U.S. regulators, including the Fed and state regulators, both of whom – along with FIO – are active participants in the development process.**

# U.S. Companies Large And Small Are Looking Outside Of American Borders For Growth Opportunities

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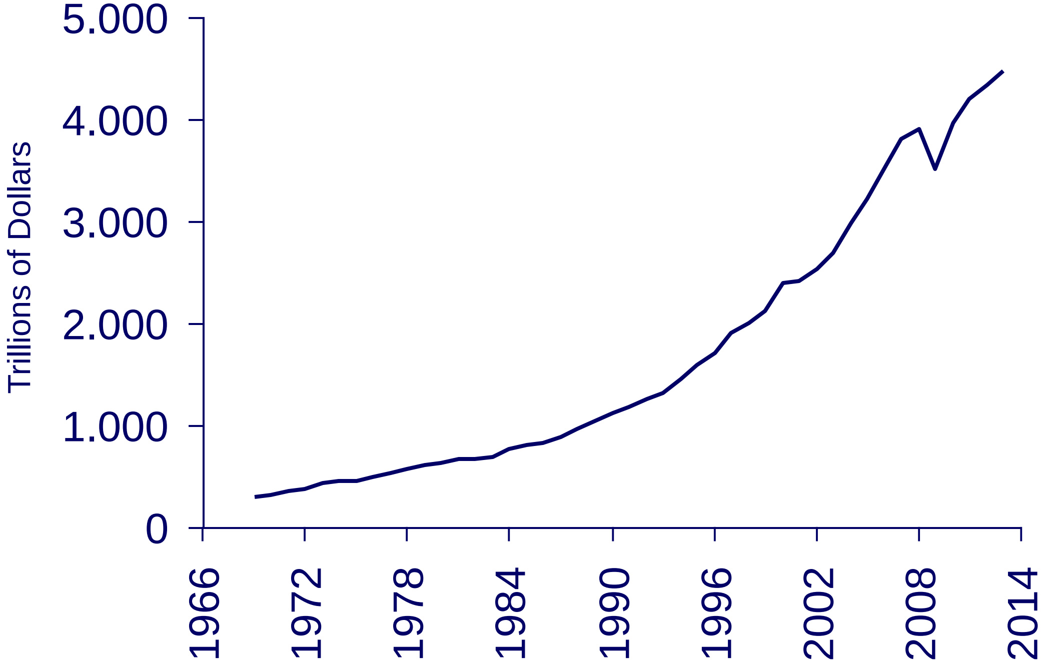
## U.S. Companies Of All Sizes Are Looking To Export

- **95 percent of the world's population and 80 percent of the world's purchasing power** is abroad.
- **98 percent of U.S. exporters in 2013 were small- or medium- sized**, with less than 500 employees.
- **About one third of all exports by dollar value were exported by small- and medium-sized companies** between 2009 and 2013.
- **Almost 50 percent of revenue from S&P 500 companies** is now derived from operations abroad.

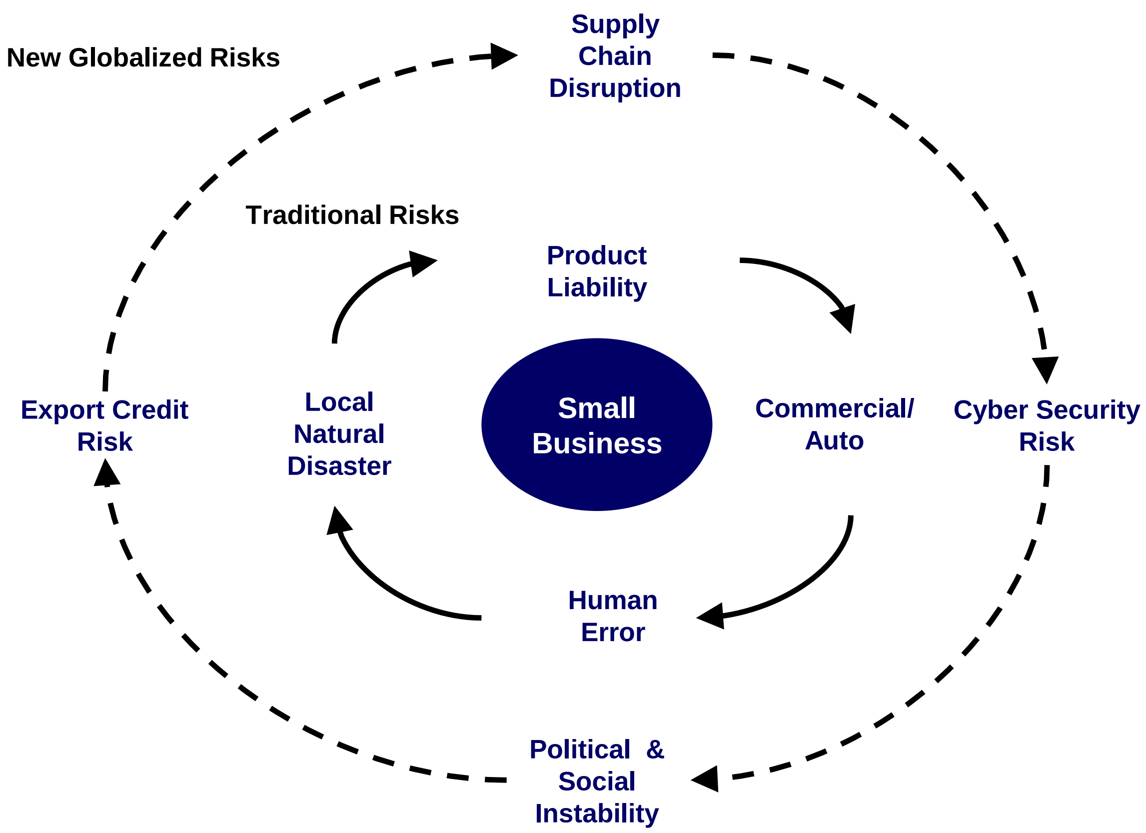
### Global Exports Of Goods And Services




Source: World Bank, Trade Benefits America

# With The Benefits Of Globalization, Comes Increased Risk Exposure For America's Businesses

## Risks Are More Connected In An Increasingly Globalized World




### Case Example

- In 2010, Eyjafjallajökull – an Icelandic volcano – erupted, dispersing ash into the sky for several months.
- The natural disaster had a direct impact on the airline community, costing more than $1 billion.
- However, the ripple affected other industries, especially perishable goods such as food and flowers, impacting small business owners and communities in Africa, South America, Japan, and the U.S.

# Global Insurers Are Uniquely Positioned To Handle Globalized Risks, Benefitting U.S. Businesses

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| Advantage | Description |
|---|---|
| **Law of Large Numbers** | • The larger the sample size, the more likely actual losses will mirror expected losses. As risks increase, management of a large portfolio of uncorrelated risks allows global insurers to provide cost-effective risk mitigation. |
| **Geographic Diversity** | • Global insurers have the ability to provide coverage with identical limits and conditions anywhere in the world and can offer a broad range of products and services to meet client needs. |
| **Increased Expertise** | • Through a global network, global insurers have the expertise to help companies optimize their breadth and depth of coverage and protect their operations around the world. |
| **Balance Sheet Capacity** | • Global insurers can accommodate market capacity that purely domestic insurers wouldn't be able to handle on their own. |

# Yet, Global Regulatory Fragmentation Unnecessarily Raises Costs For These Insurers, And Their Customers

**Zurich operates in over 170 jurisdictions, reporting to more than 100 regulatory bodies and abiding by 10+ capital and solvency standards.**

U.S. state Commissioners are working to modernize existing regulation across the 56 NAIC jurisdictions. In addition, the DFA conveyed supervisory authority to the Fed and established the FIO

After working for over a decade the EU member countries will enact Solvency II in 2016.

**Current regulatory fragmentation:**

- Inhibits insurance groups' ability to meet cross-border needs;
- Limits market expansion opportunities; and,
- Adds further complexity to regulatory compliance.

In Switzerland, the Swiss Solvency Test is applied to active insurers.

Canada and Mexico use differentiated regulatory regimes from each other and the U.S.

In South America, most countries add tailored rules on top of Solvency I, so Colombia, Argentina, Brazil, and Chile all have different standards.

Japan, Australia, Singapore and China all use differentiated regulatory regimes.

# Solution: Harmonizing International Regulations For Global Insurers Will Align Regulations With Markets

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## Market Solution

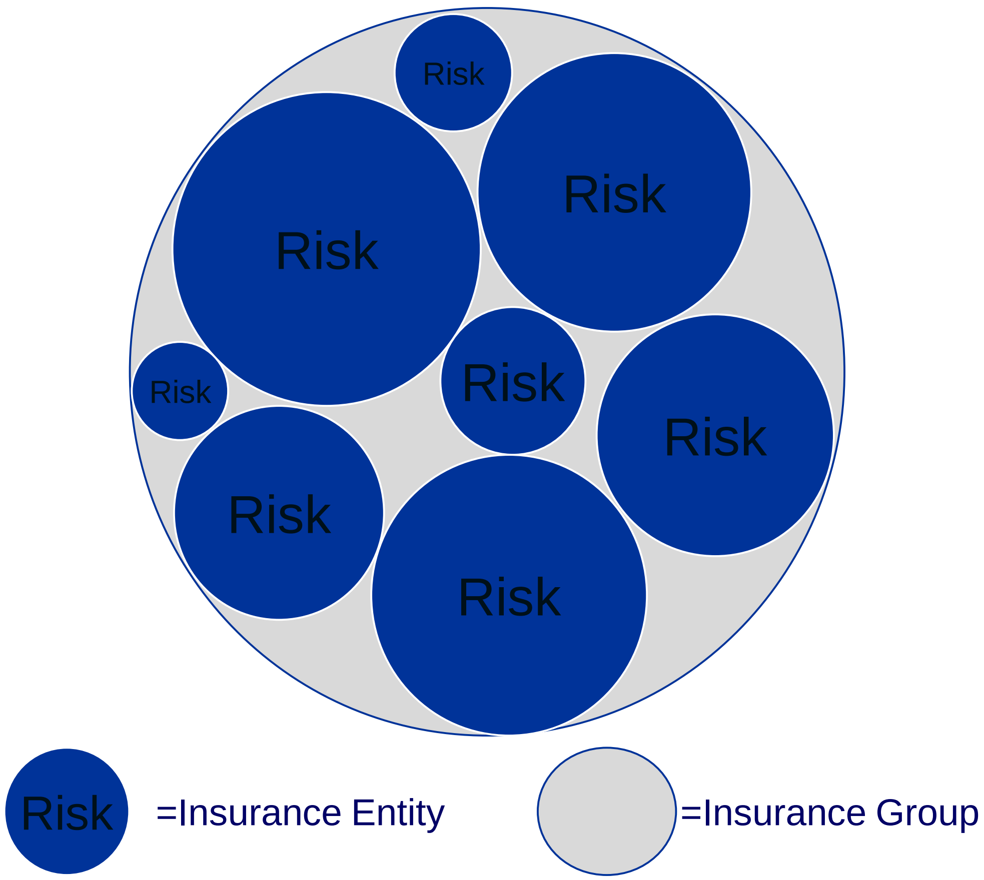
- **Regulation should reflect the realities of the global economy** so that internationally active insurance groups can best serve policyholders:
  - Develop a globally-consistent capital standard assessed at the group level.
  - Work through ComFrame to avoid costly redundancies and streamline global regulations.

## Policy Challenge

- **The high cost of compliance in an interconnected market positions internationally active U.S. insurance groups to be less competitive with global peers**.
  - Fragmentation poses enormous costs to firms looking to enter new markets, reducing competition, and outcomes for policyholders.
  - Acting as a barrier to entry, fragmentation limits market expansion opportunities and imposes parochial laws, regulations and practices on insurers that challenge their ability to effectively service policyholders.
  - The cost of entering the fragmented U.S. market incentivizes foreign insurers to purchase U.S. insurers instead of entering the markets, thus, reducing competition.

# In Particular, An International Capital Standard Will Help Global Insurers Best Allocate Resources

**Group vs Legal Entity Capital Regulation:** From The Law Of Large Numbers To The Law Of Pretty Large Numbers




- **When insurance groups can aggregate risk at the group level, it reduces costs and complexity, allowing them to deliver better products to their customers.**
- **Policyholders benefit from a harmonized international capital standard.**

# The IAIS Is A Standard-Setting Body Well Positioned To Advance Harmonization Objectives

**The IAIS mission is to promote effective and globally consistent supervision of the insurance industry** in order to develop and maintain fair, safe, and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

| Strong U.S. Representation | No Enforcement Power | Impacts 50-60 Groups |
| --- | --- | --- |
| Not only was the IAIS founded by the NAIC, a U.S. body, but commissioners from all states and territories are members and hold key positions on committees, along with Treasury and the Fed. | The IAIS is a standard-setting body with no legal authority in member jurisdictions. In the United States – without an act of Congress – individual states are the only ones who determine whether insurers in their jurisdiction must be subject to IAIS standards. | Roughly 99 percent of insurers in the United States will not be impacted by the IAIS process. Only IAIGs with written premiums in 3 or more jurisdictions and with more than $50B in assets or $10B in written premium will be impacted by ICS. The IAIS process will impact fewer U.S. insurers than Dodd-Frank. |