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Future Regulation and the Role of the P&C Actuary

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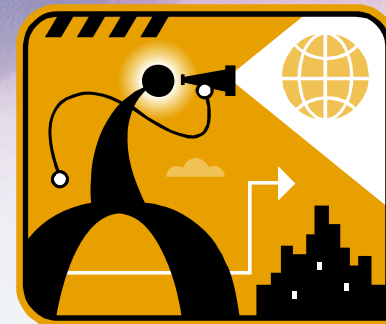
Director of Actuarial and Statistical Services, NAIC



Anthony Robbins

"It's not what's happening to you now or what has happened in your past that determines who you become. Rather, it's your decisions about what to focus on, what things mean to you, and what you're going to do about them that will determine your ultimate destiny."

What changes are on the horizon and how do you prepare?



Future Regulation & the P&C Actuary's Role

- ✧ Background
 - NAIC & International
- ✧ International Solvency & Accounting
- ✧ U.S. Solvency Modernization Initiative
- ✧ What's an Actuary to Do?

**BACKGROUND
NAIC & INTERNATIONAL ACTIVITY**

NAIC

- ✧ Created in 1871 by state insurance regulators to address the need to coordinate regulation of multi-state insurers.
- ✧ NAIC members are the state insurance commissioners.
- ✧ NAIC members have regulatory authority, but the NAIC organization does not. NAIC staff provide immense support to the U.S. insurance regulators who execute state-based insurance regulation.
- ✧ The NAIC provides a forum for the development of uniform policy, including model laws and regulations, financial reporting and RBC requirements.

Membership: Strength in Numbers

- ✧ 56 Members Strong
- ✧ 50 States + the District of Columbia
- ✧ 5 U.S. territories

(American Samoa, Guam, Northern Mariana Islands, Puerto Rico, the Virgin Islands)



NAIC Offices



KANSAS CITY – Central Office

NAIC's service and support offices assist state insurance regulators providing: financial, actuarial, legal, computer, research, market conduct and economic expertise.



NEW YORK CITY – Securities Valuation Office

The Securities Valuation Office (SVO) examines the credit quality and value of insurer's investment portfolios for the benefit of the regulatory community.



WASHINGTON, D.C. – Executive Headquarters


This office advises state regulators on policy implications of federal legislation and other federal and international actions affecting their authority over the business of insurance.



NAIC's International Participation

IAIS  International Association of Insurance Supervisors
International Association of Insurance Supervisors

IASB
International Accounting Standards Board  International Accounting Standards Board®

OECD
 ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
Organization for Economic Cooperation and Development (OECD), Insurance and Private Pensions Committee and Subcommittees

Joint Forum  BANK FOR INTERNATIONAL SETTLEMENTS

FSB  FINANCIAL STABILITY BOARD
Financial Stability Board (formerly Financial Stability Forum)

INTERNATIONAL SOLVENCY AND ACCOUNTING

International Association of Insurance Supervisors



- ✧ IAIS is a relatively new organization – 1994;
Secretariat set-up in Basel in 1998
- ✧ Membership: insurance supervisors from 150 jurisdictions (including each U.S. state) and 65 observers
- ✧ Objectives: Cooperation, Standard Setting,
Standard Implementation
 - ✧ Global Solvency Standards

International Association of Insurance Supervisors

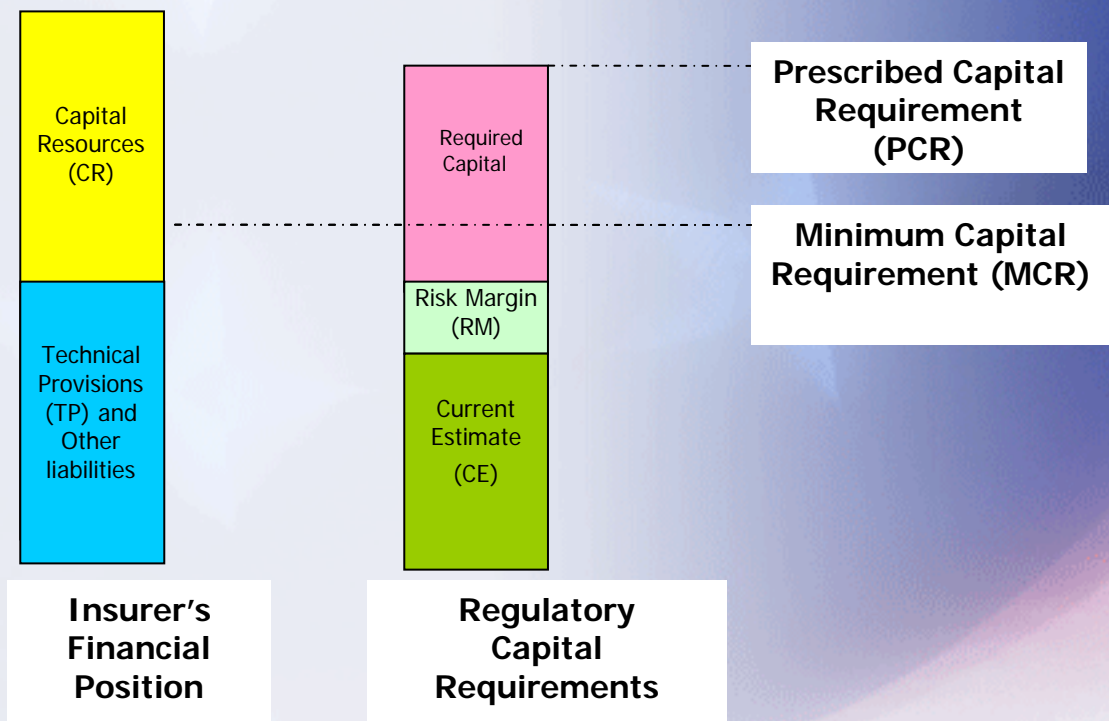


- ✧ Standards run the gamut of regulatory topics.
- ✧ For Solvency:
 - Capital Structure
 - Internal Models
 - Enterprise Risk Mgt
 - *Drafting*: Capital Resources, Asset/Liability Valuation, Investment, & Supervisory Reporting/Review

Sufficient Capital

- ✧ In adversity, policyholders will be paid as due.
- ✧ Specified Safety Level over a defined time horizon (...in Statistical Terms)
- ✧ Balance “safety” vs. increased premiums

Capital: PCR & MCR Control Levels



Calculation of Required Capital

- ✧ Range of approaches: from standardized models to internal models
 - ✧ Account for Risks: nature & materiality
 - ✧ Reflect Nature, Scale, and Complexity of insurer
- ✧ Capital Add-ons
- ✧ Capital must withstand range of predefined shocks or stress scenarios

Internal Models

- ✧ Standard is for Internal Models *Used to Determine Capital Requirements*
- ✧ Goal is to have a more accurate depiction of risk and capital needs
- ✧ Prior Approval
- ✧ Insurer must have adequate governance and internal controls
- ✧ Tests required – statistical, calibration, use

Enterprise Risk Management

Companies

- ✧ Explain their risk tolerance and explain how they are mitigating each risk type;
- ✧ Perform their “Own Risk and Solvency Assessment” (ORSA) – to assess risk management and likely future solvency position; and
- ✧ Supervisors to review insurers’ risk and capital management processes and require strengthening, where needed.

Group Issues

- ✧ Supervisory Communication Issues – Supervisory Colleges
- ✧ ERM & Internal Models, if controlled at the parent level, look at them as a group
- ✧ Group Supervisor
 - ✧ Who leads? Base on Location of Office or on Risks?
 - ✧ What happens to powers of solo-entity supervisors?

Group Capital Requirements

- ✧ Consolidated or Aggregation
- ✧ Diversification between legal entities
- ✧ Solvency II floated the idea of having Capital Requirements whereby **Solo Entities are only required to hold the MCR** ...IF...they have legally-enforceable parental guarantees

What's the IAIS Impact on U.S. Regulation?

FSAP (Financial Sector Assessment Programme)

- ✧ Began in 1999 by Initiative of IMF & World Bank

- ✧ Around 65 jurisdictions have been FSAPed

 - It's the U.S.' turn now with a report expected July 2010.

- ✧ G20, including U.S., recently reaffirmed commitment to FSAP program. (April 2009)

- ✧ IAIS Insurance Core Principles (ICPs) are used as the basis for assessing the insurance systems

IASB – International Accounting Standards Board

- ✧ A single set of high quality, understandable and international financial reporting standards (IFRSs) for general purpose financial statements.
- ✧ In 2002, the US [Financial Accounting Standards Board \(FASB\)](#) and the IASB issued their Norwalk Agreement.



FINANCIAL ACCOUNTING
STANDARDS BOARD



International
Accounting Standards
Board®

Each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting.

- ✧ In October 2008, the FASB decided to participate in the Insurance Contracts project, so this is now a joint project. However, the project is not part of the Memorandum of Understanding with the FASB (MoU).

IASB – International Accounting Standards Board

- ✧ The Board aims to publish an Insurance Contracts Exposure Draft in late 2009 and a final standard in 2011.
- ✧ What's the impact for U.S. insurance regulation?
 - Statutory Accounting Principles utilize the GAAP framework
 - GAAP pronouncements are considered for SAP: Adoption, Adoption with Modification, or Rejection
 - Difficult to Envision a SAP that is Entirely Different from GAAP

US SOLVENCY MODERNIZATION INITIATIVE

Evolution of the U.S. Solvency System

- ✧ We have developed a detailed and substantially uniform financial regulatory system in the U.S.
- ✧ In the 1990s we created risk-based capital requirements and have continued to improve the formula over time, including adding stochastic modeling and trend tests.
- ✧ SAP was codified in 2001 into a comprehensive guide and has continued to be updated & improved since.
- ✧ We are placing greater emphasis on Governance through a Model Audit Rule.
- ✧ We are proposing to modernize Reinsurance & Life Insurance Principles-Based Reserving

Evolution of the U.S. Solvency System

- ✧ What is clear is that we have been continuously improving U.S. insurance regulation for many years.
- ✧ What we have on our plates now is an investigation of new ideas and an opportunity to create the **globally preeminent** solvency system through the Solvency Modernization Initiative!
- ✧ As we move toward change in the U.S. to achieve the Gold Standard, we also will dialogue outward in our U.S. international activities.

Solvency Modernization Initiative (SMI)

Five **Focus Areas** of SMI:

- ✧ Capital Requirements
- ✧ International Accounting
- ✧ Group Supervision
- ✧ Valuation Issues in Insurance
- ✧ Reinsurance

SMI Work Plan – Intl Solvency and Acct WG

- ✧ Analyze other financial supervisory modernization initiatives, to the extent appropriate. Analysis should include:
 - the Basel II international capital framework for banks and implementation in the U.S.;
 - solvency work by the International Association of Insurance Supervisors (IAIS);
 - solvency proposals under consideration in other jurisdictions, including Australia, Canada, Switzerland and the EU;
 - accounting standards being developed by the International Accounting Standards Board (IASB).
- ✧ As an on-going process, and as details emerge, complete the analysis of Europe's Solvency 2 framework.
- ✧ Identify areas for U.S. regulators to consider including in the current NAIC programs.

SMI Work Plan – Group Solvency

- ✧ Holding Company Model Act
 - Assess needed changes based upon lessons learned from the most recent economic downturn
 - Study international solvency issues related to groups and consider changes to the model
 - Investigate the need to develop group-wide supervision, possibly group-wide capital requirements
- ✧ Recommend Courses of Action Regarding Supervisory Colleges and Other Cross-Border and Cross-Sectoral Coordination/Communication Efforts

SMI Work Plan – International Relations (G) Committee

- ✧ Present the US-EU/S2 comparison to the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the European Commission for comment and verification.
- ✧ In coordination with the Financial Condition (E) Committee, identify issues to present for discussion with CEIOPS and the Commission in the US-EU Insurance Regulatory Dialogue.
- ✧ Follow discussions in Europe on the impact of EU/S2 on U.S. insurers and reinsurers doing business in Europe. Consider analysis of the possible international trade implications of the treatment of U.S. (re)insurers under EU/S2, and interact with the Office of the U.S. Trade Representative, where appropriate.

SMI Work Plan – Principles-Based Reserving

- ✧ Continue with the Principles-Based Reserving Initiative to focus on the principles-based valuation of insurance reserves.
 - A revised Standard Valuation Law (SVL) is currently being finalized at the NAIC.
 - The SVL would be supplemented by an NAIC Valuation Manual.
 - Modifications are proposed for new business for certain life and annuity products only.

SMI Work Plan – Reinsurance

- ❖ Two new classes of reinsurers in the United States:
 - ❖ U.S. domiciled national reinsurers
 - ❖ Non U.S. based port of entry (POE) reinsurers
- ❖ Includes an opportunity for single-state supervision of U.S. reinsurers and single-state certification for non-U.S. reinsurers.
- ❖ Collateral requirements are relaxed for eligible reinsurers
 - in line with the financial strength of the reinsurer domiciled in approved jurisdictions.
- ❖ The Board of a Reinsurance Supervision Review Department (RSRD) will be established to evaluate the reinsurance supervisory regimes of other countries and establish standards for a state to be certified as a single state regulator.

SMI Work Plan – Framework and Principles

- ✧ Develop a Framework Document that Describes the U.S. Solvency System
- ✧ Compile U.S. Principles from Multiple Sources
- ✧ Evaluate All for Modification in the Solvency Modernization Initiative
- ✧ Create a Roadmap for the SMI

ROLE OF ACTUARIES

The Role of Actuaries in Insurance

- ✧ The IAIS has a paper on the role of actuaries.
- ✧ The application of actuarial expertise is a key component in the operation of insurers, insurance markets and insurance supervisory authorities
- ✧ An actuary evaluates the financial implications of contingent events. **Actuaries require an understanding of the stochastic nature of insurance, the risks inherent in assets and the use of statistical models.** These skills are often, for example, used in establishing premiums and technical provisions for insurance products, using the combination of **discounted cash flows and probabilities.**

The Desire of the Supervisor to Encourage Change

- ✧ The supervisor may introduce an official role for an actuary in order to encourage insurers to make greater use of actuarial techniques
- ✧ May require reports to be signed by an actuary.
- ✧ May require actuaries to dialogue with supervisors.
- ✧ The use of actuarial skills and advice can enhance the internal assessment of risk in an insurer, as well.

The Requirement to Have a “Responsible Actuary”

- ✧ The appointment of a particular responsible actuary should be subject to supervisory review.
- ✧ The Supervisor and/or company should be able to remove the Appointed Actuary.

Removal may be required where the actuary fails to perform adequately the required functions and duties or does not meet eligibility or fit and proper criteria. The supervisor should be promptly informed in cases where the insurer removes the responsible actuary

- ✧ In cases where an actuary has been removed, it is also important that the new actuary communicates with the former actuary to determine whether there was any professional reason for the change

Requirements to provide advice to the insurer

In countries where a responsible actuary model is in place, the role of the actuary should be defined in terms of the types of advice that the actuary is required to give the insurer, for various lines of business.

The actuary should provide advice on the level of technical provisions. Consideration should also be given to other areas where advice of the actuary will be valuable, such as:

- levels of premiums;
- adequacy of risk assessment;
- reinsurance arrangements;
- investment policies;
- statistical inference; and
- stress testing of the future financial condition of the insurer.

Future for P&C Actuaries

- ✧ Prepare yourself by freshening up on **insurance valuation techniques, interest rates & discounting**.

- IAA Current Estimates & Risk Margin paper

- http://www.actuaries.org/LIBRARY/Papers/IAA_Measurement_of_Liabilities_2009-members.pdf

- ✧ Get involved with **Enterprise Risk Management**.

- CAS Enterprise Risk Mgt Website <http://www.casact.org/research/erm/>

- ✧ Use **statistical models** to analyze reserves and risks.

- ✧ Influence senior management to build and use **internal models** for economic capital and risk management.

- IAA Internal Models paper – being drafted

- http://www.actuaries.org/CTTEES_SOLV/Documents/Tallinn_item2.pdf



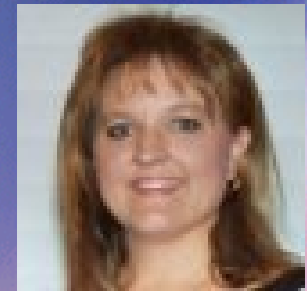
Anthony Robbins

*"If you do what you've always done,
you'll get what you've always gotten."*

Kris DeFrain

*"Be Tech-y because actuaries add value
that way, but remember:*

*communication and
use by management are key!!"*



...okay, I'm no Anthony Robbins!