

U.S. Solvency Modernization Initiative



Casualty Actuarial Society's Casualty Loss Reserve Seminar (CLRS), Chicago, September 2009

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National Association of
Insurance Commissioners

NAIC and International Activities



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



International Association of Insurance Supervisors

IASB

International Accounting Standards Board



OECD



Organization for Economic Cooperation and Development (OECD), Insurance and Private Pensions Committee and Subcommittees

Joint Forum



FSB



Financial Stability Board (formerly Financial Stability Forum)

International Association of Insurance Supervisors



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



International Association
of Insurance Supervisors

✧ Standards run the gamut of regulatory topics.

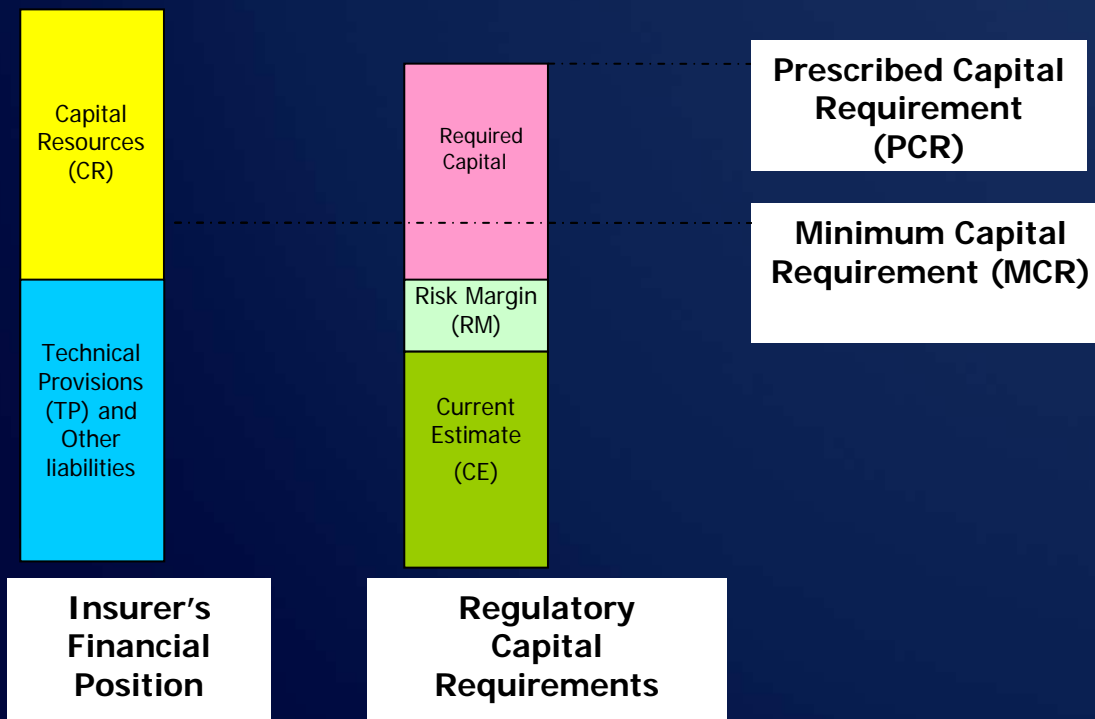
✧ For Solvency:

- Capital Structure
- Internal Models
- Enterprise Risk Mgt (incl. ALM)
- Capital Resources
- *Drafting*: 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**

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 early 2010 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

Solvency Modernization Initiative



Evolution of the U.S. Solvency System

- US regulators have developed a detailed and uniform financial regulatory system over its years of existence.
- In the early 1990s, the NAIC's Solvency Policing Agenda resulted in a number of major changes to financial regulation (e.g., RBC, accreditation, FAST system, FAWG)
- There's been continuous improvement over the past 20 years resulting in many modifications (e.g., model audit rule, risk-focused exams, uniform statutory accounting model)
- Today, global and national developments call for another comprehensive review.

Impact of the Current Financial Environment

- The financial crisis has increased the relevance of international standards
 - FSAP process introduced in 1999
 - IAIS developed principles for insurance
- “Each country pledges to review and report on its regulatory system . . . (A)ll G-20 members commit to undertake a Financial Sector Assessment Program (FSAP) report.”
 - November 2008 G20 Financial Summit declaration
- The U.S. is currently undergoing a FSAP review.

Other Initiatives

- International accounting standards
- Solvency II
- Increased attention to supervision of internationally active groups
 - AIG
 - Group supervision
 - Supervisory colleges

Solvency Modernization Initiative (SMI)



1. Describe the U.S. system based on a coherent set of principles.
2. Examine international developments and their potential use in U.S. insurance regulation.
 - 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 in place or under development in other jurisdictions, including Australia, Canada, EU, and Switzerland;
 - International accounting standards being developed by the International Accounting Standards Board (IASB).
3. Critically review the entire solvency regulation framework in the U.S.
 - Keep what is working well and add requirements as needed.
 - Modify or delete requirements that are not working well.

SMI Focus Areas

- Focus areas:
 - International Accounting (Statutory Accounting and Reporting)
 - Insurance Valuation (Principle-Based Reserving)
 - Capital Requirements (Risk-Based Capital)
 - Group Solvency Issues (including Group Capital Requirements)
 - Reinsurance (Adopted Reinsurance Modernization Framework)
- Other Considerations:
 - Enterprise risk management
 - Corporate governance

Center for Insurance Policy & Research

Ramon Calderon, Director

Mary Weiss, Distinguished Scholar

Ed Toy, Capital Markets Specialist

- Drafting the Current U.S. Framework
- Studying RBC: Factors, Formulas, Methodology
 - Cash Flow Simulation
- Evaluating other Solvency Systems, starting with Swiss Solvency Test
- Investigating Insurer Behavior Changes since the Implementation of RBC
- Identifying potential enhancements to investment analysis to better support our new risk-focused supervisory approach

SMI Issues for Consideration

Adopted by SMI (EX) Task Force

as Recommended by the International Solvency and Accounting (EX) Working Group



Ideas that Merit Consideration

- Economic Capital
 - Benefit from knowing what enters the company’s calculation of their economic capital as well as how the company interprets and uses it.
- Enterprise Risk Management
 - Just as the enhanced risk-focused financial examination process is implementing a prospective risk analysis, a company’s “Own Risk and Solvency Assessment” (ORSA) could be useful in assessing solvency positions.
- Internal Models, Full or Partial Models
 - RBC is risk-focused and we have some modeling involved.
 - With prior approval and other safeguards, internal models could be a way for regulators to more accurately assess the capital needs of a company.

Ideas that Merit Consideration



- RBC
 - Analysis of our ladder of supervisory intervention
 - (Company Action, Regulatory Action, Authorized Control, Mandatory Control Levels)
 - What is the “safety level” of the U.S. system in statistical terms? Are the current factors appropriate?
 - How should internal models be used within RBC?
 - Where used, how do we coordinate on the evaluation and approval of models?

Ideas that Merit Consideration

- Group Issues
 - Insurance Holding Company System Regulatory Act
 - Group Supervision – Model Law
 - Group Supervisory Colleges
 - Non-Regulated and Federally Regulated Entities within a Group
 - Group Capital Requirements

Ideas that Merit Consideration

- Reinsurance Modernization
- Insurance Valuation – PBR
- Corporate Governance
 - Model Audit Rule and PBR
 - Broader governance framework
- Systemic Risk
- Impact of Accounting Changes

SMI Process – Next Steps

- Articulate our Current Framework/Principles
- Decide whether adjustments should be made to the Framework/Principles.
- Continue studies & identify additional ideas.
- Develop a Roadmap for SMI implementation.

Follow this Work

NAIC Website: www.naic.org

Select “Committees & Activities”

Expand the list for “Executive (EX) Committee”

Select:

- Solvency Modernization Initiative Task Force
- International Accounting Standards Working Group
- International Solvency Working Group
 - See the “Issues for Consideration in the SMI” document
- Group Solvency Issues Working Group
- Principles-Based Reserving Working Group

Get on an e-mail distribution list – kdefrain@naic.org

(It’s FREE! And who doesn’t love that?)