

Antitrust Notice

- The Casualty Actuarial Society is committed to adhering strictly to the letter and spirit of the antitrust laws. Seminars conducted under the auspices of the CAS are designed solely to provide a forum for the expression of various points of view on topics described in the programs or agendas for such meetings.
- Under no circumstances shall CAS seminars be used as a means for competing companies or firms to reach any understanding – expressed or implied – that restricts competition or in any way impairs the ability of members to exercise independent business judgment regarding matters affecting competition.
- It is the responsibility of all seminar participants to be aware of antitrust regulations, to prevent any written or verbal discussions that appear to violate these laws, and to adhere in every respect to the CAS antitrust compliance policy.

**Solvency Modernization Initiative:
The Times They are a Changing!**

A Company's Perspective

William R. Sergeant, CPA, CPCU, CLU, ChFC, FLMI
Director, Office of Accounting Policy
State Farm Insurance

CAS Loss Reserve Seminar
September 20, 2010

2

SMI - Company Perspective

- ❖ Capital Requirements
- ❖ Group Supervision
- ❖ Accounting Standards

3

SMI - Company Perspective

- Capital Requirements
 - Focus on assuring the adequacy of an insurer's financial resources to meet its policyholder obligations, with a reasonable level of assurance
 - Should enhance regulators' ability to identify companies approaching capital inadequacy

4

SMI - Company Perspective

- Capital Requirements (cont.)
 - Support current RBC with appropriate modifications
 - RBC is risk focused, flexible, consistently applied across the industry, transparent, cost effective, easy to use and understand, difficult to manipulate, and applied at the individual company level.

5

SMI - Company Perspective

- Capital Requirements (cont.)
 - Regulators should be more concerned with the "Sufficiency of Capital" rather than the "Efficiency of Capital"
 - Economic or target capital not appropriate for determining regulatory capital levels
 - Helpful to regulators, in overall risk assessment, to understand and consider capital management techniques and methodologies used by insurers.

6

SMI - Company Perspective

- Capital Requirements (cont.)
 - Use of modeling – approach with great caution
 - Use of partial models is appropriate where formulaic approach doesn't work and where consistent application is possible
 - Cat loss models are important to consider
 - Use of company developed internal models to set capital requirements is not appropriate
 - It's not cost effective to develop and maintain necessary modeling expertise in each insurance department

7

SMI - Company Perspective

- Capital Requirements (cont.)
 - RBC formulaic method better for minimum capital requirements
 - RBC sets regulatory action levels.
 - "Capitalism without insolvencies is like religion without sin."
 - Regulatory role should be to minimize impact of insolvencies, not necessarily to prevent them

8

SMI - Company Perspective

- Group Supervision
 - How far should it go? How far can it go?
 - Support for "Windows and Walls" approach
 - Walls around affiliate transactions
 - Windows into other group members' activities
 - Solvency surveillance – monitoring and evaluation
 - Group Capital Assessment – Qualitative vs. Quantitative

9

SMI - Company Perspective

- Group Supervision (cont.)
 - Current regulatory authority based on legal entity
 - Companies can't be forced to move capital
 - Therefore, group capital requirements won't work
 - Group support / fungibility of capital – How would a regulator assure themselves capital would be available when needed?
 - Group supervision limited to assessment and monitoring

10

SMI - Company Perspective

- Group Supervision (cont.)
 - Group solvency assessment appropriate to understand potential for group contagion, reputational, operational risk etc. posed by group members
 - Must be coordinated with other non-insurance regulators
 - College of Supervisors may be valuable
 - Utilize existing risk focused examinations to understand the risks faced by companies/groups

11

SMI - Company Perspective

- Accounting Standards - SAP, GAAP, or IFRS?
 - Statutory Accounting Principles (SAP) are a standalone comprehensive basis of accounting
 - SAP is built on a foundation which includes GAAP
 - All new GAAP standards are considered for inclusion in SAP (accepted, rejected, or modified)
 - SAP sometimes considered 'GAAP with modifications'
 - Solvency framework (e.g. RBC, IRIS) based on SAP reporting

12

SMI - Company Perspective

- Accounting Standards (cont.)
 - Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) are converging into one set of global accounting standards
 - SEC is working on a roadmap for adoption of IFRS reporting in the US
 - FASB and IASB are jointly working on an insurance contract standard

13

SMI - Company Perspective

- Accounting Standards (cont.)
 - Potential for significant change in insurance accounting model
 - Probability weighted cash flows,
 - Discounting
 - Risk margins
 - NAIC's Statutory Accounting and Financial Reporting Subgroup is considering the future of SAP with the possible replacement by GAAP/IFRS

14

SMI - Company Perspective

- Accounting Standards (cont.)
 - Should GAAP/IFRS replace SAP?
 - To the extent possible the same accounting model should be used for both general financial reporting and solvency/regulatory reporting purposes
 - Significant uncertainty of future GAAP/IFRS standard
 - Need for common global standards
 - Why change if not broken?
 - RBC and other solvency tools would need to be re-calibrated

15

SMI - Company Perspective

- Should GAAP/IFRS replace SAP?
- Elimination of duplicative standard setting processes
- NAIC would consider changes to RBC as accounting standards change
- Significant costs to SAP only insurers to convert to GAAP/IFRS
- Potential for Federal regulation which may require GAAP reporting
- Significant Tax implications
- Too much uncertainty to decide now

16

SMI - Company Perspective

In Summary,

We support the work of the SMI taskforce and appreciate the openness and consultative nature of their work

The current solvency framework has proven to be effective. It just needs to be updated, not replaced

Sound solvency regulation is good for the industry, our policyholders, and the economy as a whole

17

SMI - Company Perspective

Questions or comments?

18
