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Keynote Speech: Solvency II from a Transatlantic Perspective

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Mr. Chairman, distinguished guests, ladies and gentlemen, on behalf of your US colleagues; I want to thank you for the invitation to participate in the 2006 CEIOPS Conference. As both the Chair of the International Association of Insurance Supervisors Executive Committee and the President of the National Association of Insurance Commissioners, I welcome each and every opportunity to enhance our regulatory cooperation and am honored to be a part of the 2006 CEIOPS Conference program. We all recognize that Solvency II is a major project designed to develop a regime of insurance solvency that will be deployed throughout the European Union. The global insurance community is anxiously awaiting its completion, which will truly exemplify the fundamental nature of a single European market for insurance. The growing economic interdependence of countries makes it even more important for us all to understand the impact of Solvency II.

Today, I want to take this opportunity to share with you some of my thoughts on the significance of securing an effective solvency regime, the current work of the NAIC's risk based capital supervision and the importance of the US' engagement in global solvency initiatives. I will also highlight some of the other international insurance activities where the US has been actively involved.

While many of you are probably familiar with the NAIC, for those of you who are not, the NAIC is the association of state insurance commissioners from the 50 states, Washington, DC and 5 US territories. Formed in 1871 to address the need to coordinate regulation of multi-state insurers, we have been meeting for more than 135 years to share our experiences in insurance regulation. Included in our mission is the need to maintain the appropriate balance between individual states and the insurance markets as well as to support the harmonization of state regulatory practices. This is essential to providing an effective framework for insurance regulation in the US.

Since our first meeting in New York in 1871, the NAIC has evolved into a multidimensional regulatory support organization and has developed an extensive body of work in the form of model laws and regulations, handbooks and manuals, which also include financial and market conduct exams. To ensure that all states have the same basic laws and rules on financial matters, in the early 1990's we established the Financial Regulatory Standards and Accreditation Program. This rigorous accreditation program covers topics ranging from risk based capital and financial exams to laws on reinsurance

and insolvency. We certainly benefit from having a single set of statutory accounting principles and a standard regulatory reporting form used by all insurers doing business in the U.S.

To meet the needs of today's global consumers, I am a firm believer that the US regulatory community must continue our efforts to be actively engaged in the processes and forums that lead to greater international coordination. To that end, the NAIC-EU Dialogue that began nearly 8 years ago is a prime example of that commitment, a commitment on both sides of the pond. Through our regular meetings, it has become more apparent that we face many of the same regulatory challenges, although I prefer to view those challenges as opportunities. For example, as Europe moves towards a single market for financial services, especially during periods of enlargement, I think that the experiences of sub federal supervision in the US can serve to illustrate some of the best practices.

As I have often stated, the US insurance regulatory community is strongly committed to following the work of Solvency 2 and sharing with you our thoughts on the various components of the project. We have dedicated NAIC actuarial staff that review each phase of Solvency II and provide feedback to the US regulatory community at our quarterly national meetings. Just last year, the NAIC created a working group called the International Solvency Initiatives Working Group, under the NAIC's Financial Condition E Committee. Its charge is to critically review and provide detailed assessments on the work of the IAIS' Solvency and Actuarial Issues Subcommittee. This process has the benefit of educating both supervisors and market participants. I believe that the latter group must pay more attention to the Solvency II developments. We look forward to analyzing the results of your qualitative impact studies which provide an important "road test" for the new ideas being developed in this project.

US insurance supervisors understand the importance of being committed to monitoring and staying engaged in the solvency initiatives around the world. While the EU goes through the process of introducing a new solvency regime, the NAIC too is in the process of reviewing our risk based capital approach to solvency supervision. To understand the current perspective in the US, I would like to draw attention to the link between the activities of US and international solvency initiatives.

In the US, regulators have been reviewing whether or not formula-based rules for reserves and capital can accurately reflect the range of risk profiles of insurance companies. While Solvency II is a principles-based approach, the RBC system introduced in the US in 1994, is a rules-based system that requires analyses that are exactly defined and strictly rely upon US statutory accounting practices. Many US regulators now acknowledge that the current reserve methodologies do not adequately address the benefits, revenues, and risk characteristics of insurance products being offered and that a more permanent, principle-based solution is needed. In particular for life insurance products, this has become increasingly evident as companies offer more complex products and investments. Consequently, this has fueled the need for new complex tools to better assess the financial underpinnings of the companies.

As a result, a major effort is currently underway to develop a modeling-based approach for life insurance reserves using assumptions for each individual company. While the traditional system uses more prescribed formulas and assumptions, a principles based system has a process of identifying and measuring all risks. The NAIC has created a Principles-Based Oversight Committee whose responsibilities include working toward the implementation of a principles based system. In just a few weeks at our December National Meeting, the NAIC will receive several recommendations for a policy framework. Some of the objectives of the NAIC RBC formula development include; 1) adjusting minimum capital and surplus requirements to reflect a company's risk exposure; 2) providing capital adequacy standards that is related to risk; 3) raising a safety net for insurers; and 4) and ensuring uniformity among states. As this process moves forward, it is important to understand that US regulators have a dual responsibility, 1) to develop and articulate a sound public policy for establishing a principles approach and 2) creating the technical framework for implementation and monitoring.

As the development of the public policy advances, a number of questions are being considered such as — How will all of the states convert to the principles based system uniformly? Will there be more pressure on regulation and management? Will there be greater accuracy and better disclosure?

At this time the NAIC is concurrently working to develop a valuation manual approach for establishing reserves and a new standard valuation model law that the states can adopt. This will not be an easy process and will take extensive resources and a high degree of judgment, but we are committed to considering changes to our traditional rules based system to a more principles based system.

The accelerated pace of globalization is changing the shape of all financial services and the insurance market is no exception. The IAIS is now considered by many to be “the insurance setter standard of the world.” As the association of insurance supervisors from over 100 jurisdictions, the IAIS has undertaken perhaps the one of the most challenging project to date: the move towards a common structure and standards the assessment of insurer solvency. The intended goal is to enhance transparency and comparability of insurer solvency and of solvency regimes worldwide. As a result, this effort will benefit insurance consumers, industry, supervisors, investors and other interested parties. After issuing an IAIS Roadmap paper in February 2006 that builds upon the earlier Solvency Framework and Cornerstones papers the first deliverable from that Roadmap is the *Common Structure For The Assessment Of Insurer Solvency*. The paper describes the overall IAIS risk based approach to the assessment of insurer solvency, and in particular articulates principles for the setting of financial regulatory requirements. This project has seen an increased level of interest and participation from many supervisors and interested parties alike.

When looking at Europe's Solvency II project and other moves to principles-based approaches to supervision, it is essential that the IAIS Structure Paper establish a critical

base for future work in this area. As you continue to pursue the Solvency II project, I encourage everyone — supervisors and market participants alike to follow the critical work of the Solvency and Actuarial Issues Subcommittee. As I understand it, one of the key objectives of Solvency II is to incorporate international developments with the aim of further convergence in prudential standard setting. I have no doubt that the European insurance supervisors are actively engaged and I commend your tireless effort to protect your policyholders and establish a measure of solvency that better reflects the risks to which an insurer is exposed.

The NAIC has also taken a critical look at the work of other jurisdictions to learn from their experience. We have closely followed the Swiss Solvency Test (SST) project, which focuses on elaborating a risk-oriented supervision. Like the EU's Solvency II project, the SST system, launched in 2003, is principle based and is based on market consistently valued assets and liabilities. US regulators have also studied the experience of the UK and Canada who have moved away from using a rules-based system, and we have taken note of their different supervisory systems.

The knowledge gained through these efforts is also benefiting the NAIC Reinsurance Task Force as they attempt to develop alternatives to the current reinsurance regulatory framework, including the use of collateral within the U.S. and abroad.

Over the next several weeks, Task Force members will continue to refine a proposal for U.S. regulators to amend the credit for reinsurance laws by establishing a regulatory system that distinguishes financially strong reinsurers from weak reinsurers, without relying exclusively on their state or country of domicile. In its current form the proposal would create an organization called the Reinsurance Evaluation Office (REO) to rate the financial strength of reinsurers doing business in the U.S., irrespective of the reinsurer's country of domicile. State insurance regulators, through the REO, would establish procedures for the evaluation of the financial strength and operating integrity of reinsurers and, based on the outcome of the evaluation, assign a rating to each reinsurer. These ratings will be affirmed or modified through periodic reviews by the REO.

The analysis would incorporate insurance financial strength ratings assigned by nationally recognized statistical rating organizations ("NRSROs") and the expertise of the NAIC for evaluating other key factors deemed appropriate. The analysis will also include a review of the financial strength and operating integrity, business operations, claims paying history, management expertise and overall performance of reinsurers in assigning ratings ("credit criteria"). The amount of collateral to be posted by the reinsurer will be dependent upon its REO rating.

With over 135 years of experience in insurance regulation, the NAIC is fully supportive of efforts to raise the quality of insurance supervision around the world. In an effort to help countries devise a base line of regulation that will assist them to open their markets, establish markets for foreign capital, NAIC members regularly share information with insurance supervisors and participate in technical assistance and training in many countries. Started three years ago, our International Internship Program is part of our

growing international collaborative efforts to help regulators gain insight into how insurance supervision is conducted in the U.S. by which regulators from around the world can learn how regulation is carried out in the U.S. Participants in this fall's program include regulators from China, Russia, Brazil, British Virgin Islands and Korea. It is not only beneficial to the non-US regulators, but it is extremely valuable for our own regulators who will have a much better understanding of how insurance supervision is conducted worldwide. We hope that by increasing the "capacity building" of various markets, this will lead to greater access to products and services and provide the highest level of protection. While many of our technical assistance efforts have been focused on emerging markets, we welcome the discussion of a program that would focus on extended training that would be highly beneficial to those supervising non-domestic companies.

Since many of us have recently returned from the recent IAIS Annual Conference in China, I think it is appropriate to quote from an ancient Chinese proverb, "may you live in interesting times". There is no question that we are indeed living in interesting times when it comes to the financial services markets. As insurance supervisors we are in a unique position to help shape a supervisory framework that will serve insurance consumers worldwide in a prudent and hopefully, profitable manner. I wish you good luck as you continue on the path to Solvency II. Thank you again for the opportunity to be here.