

**International Association of Insurance Supervisors  
Solvency & Actuarial Issues Subcommittee:**

**Summary of the Tokyo Meeting**

**Presented to the  
NAIC's International Solvency and Accounting (E) Working Group**

Rob Esson (NAIC) and Kris DeFrain (NAIC) represented the U.S.A. at the International Association of Insurance Supervisors' (IAIS) Solvency and Actuarial Issues Subcommittee meeting in Tokyo March 28-30, 2007. The following is an overview of the activities and reports presented to the Subcommittee:

**IAIS Committee Structure & Organization**

The IAIS Executive Committee would meet in April 2007 to consider issues about Subcommittees and whether some Subcommittees should be merged. Rob Curtis specifically mentioned the potential to merge the Solvency Subcommittee and Financial Conglomerates. In the drafting of standards and papers, the IAIS will be investigating new ways to organize to avoid conflicting positions between Subcommittees. Roadmaps to expand strategic policy and work plans are expected to be more fully used as a planning tool.

As always supported by the U.S., interested parties asked for the Technical and Executive meetings to be more open. Karen Doran (IAIS) said that issue is under discussion.

**IAIS Solvency Subcommittee's Current Draft Papers**

Four papers were identified in 2006 to be written by the Subcommittee in 2007:

- 1. Guidance paper on the Use of Internal Models by Insurers**
- 2. Standard on Enterprise Risk Management for Solvency Purposes**
- 3. Standard on the Valuation of Assets and Technical Provisions**
- 4. Standard on Regulatory Capital Requirements and Capital Resources**

The format of these papers was discussed. The standards papers would be high-level principles and then separate "Application Guidance" (or "implementation measures") would be drafted later. The application guidance would be "living documents" that could be changed more often than standards would be expected to change. This approach contrasts to the *IAIS Common Structure for the Assessment of Insurer Solvency* (Structure paper), that contained principles merged with application guidance. There was discussion to co-author the application guidance with the International Actuarial Association (IAA), industry, and potentially other groups (especially some from non-actuarial disciplines). Since the legal environment differs, many expressed preference that details should be left to jurisdictions.

**IAIS Solvency Subcommittee's Guidance Paper on Internal Models**

The drafting Subgroup, led by the UK, re-drafted the internal models guidance paper a week prior to the meeting. Some additional changes are expected in the weeks following the meeting, but not major re-writing. The chair still expects to submit the document to Technical Committee for approval in Fort Lauderdale in October 2007.

Some issues discussed:

- A confidence level was included in the paper at 99.5% confidence level. The Subcommittee agreed to remove that prescriptive safety level, at least for now. It was noted that a confidence level must be accompanied by a method (e.g. Var, TVar) and a time horizon in a definition.
- The Calibration Test needs to be further developed and explained.
- Regulatory oversight of models needs to be established. Regulators need to make sure a model really fits the company.
- What should be input into a model before the output should be allowed to be used?

### **IAIS Solvency Subcommittee's Standard on Risk Management**

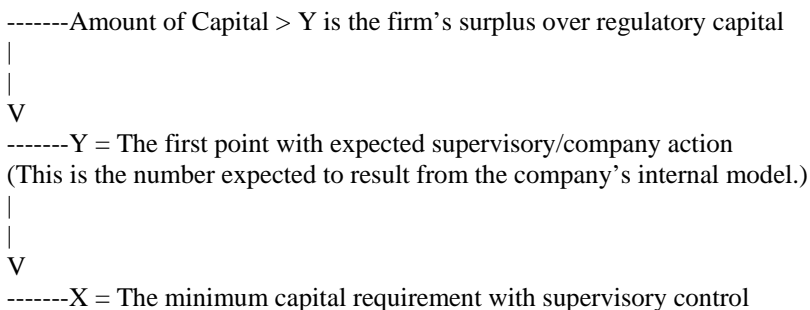
The drafting Subgroup, led by the UK, re-drafted the risk management standard a week prior to the meeting. Some additional changes are expected in the weeks following the meeting, but not major re-writing. The chair expects to expose the document in April for discussion at the June meeting, and to submit the paper to Technical Committee for approval in Fort Lauderdale in October 2007.

Some issues discussed:

- Focus should be on individual company, although how a group structures and manages risk is relevant. Supervisors should be aware of how a company operates.
- The paper should avoid being prescriptive. Defined risks might lead to a perception that those risk categories are how a company must model.

### **IAIS Solvency Subcommittee's Standard on Capital**

The drafting Subgroup, led by the Australia, said the paper will be modified significantly prior to the next Subcommittee meeting. The principles will be separated from the application guidance. The issue of going concern vs. winding up will be addressed. And, most importantly, the level of solvency being discussed was found to be slightly different by jurisdiction, so a common terminology was established.



Note: As the company's capital gets farther from Y, the calculation should turn from more of a going concern calculation to a winding up calculation.

Some additional issues discussed:

- The chart by country included in the draft would not be in the Standard.
- Capital tiers: and should those tiers vary between control level Y and X.
- Capital should not be set too high in an attempt to prevent all insolvencies.
- Use phrases "public disclosure" and "supervisory reporting" to distinguish between the two types. Disclosure might be different between levels Y and X.

### **IAIS Solvency Subcommittee's Standard on the Valuation of Assets and Technical Provisions**

The drafting Subgroup, led by the US (Rob Esson), said that since the IASB is issuing their Discussion paper soon and the IAIS will comment on that paper, this standard should be delayed until after those IAIS comments are determined. While the idea met resistance, it was agreed that the standard would not be ready for submission to Technical in October. Significant debate focused on what actions the Subcommittee should take now.

- One idea from Rob Esson was to create a statement from Technical and/or Executive saying preference is to use general purpose accounting for prudential reporting, with some limited potential differences, and that the IAIS would issue a standards paper in due course. In this way, intentions of the IAIS would be on record, but some maneuverability and options with the IASB would remain available and open. The EC said they do not want to take the IASB position as a blank check and that there are some differences to address such as own credit rating, profit at issue, and full fair value. The EC suggested saying the IAIS plans to have maximum consistency. Helen Rowell said that the Australian position was that an IAIS standard on valuation would more strongly influence the IASB.
- While delay of a standard was an acceptable compromise for some, those participants also strongly supported the position that a standard on valuation must be written and should be written sooner rather than later.

- Rob Esson suggested moving to the next step and working on risk margins, discounting, etc.
- The EC offered their draft text on valuation as a possibility to begin an IAIS Standard. Rob Esson noted that the draft reflects what's already in the IAIS's Second Liabilities paper as written by the IAIS Insurance Contracts Subcommittee. He questioned the need to repeat information already established as the IAIS position.

Given disagreement by the Subcommittee, higher-level committees must address the timeframe. Rob Curtis suggested that Executive was meeting in April and could decide. However, Rob Esson said that it would be inappropriate to jump the Technical Committee.

Some issues about liability valuation were discussed:

- The reference entity needs further explanation. For example, with a reference entity, whose expenses would be used? Expenses are identified as being portfolio-specific, which differs some from entity-specific. It was noted that the 2<sup>nd</sup> Liabilities paper states that a reference "framework" should be used and not an "entity". Think of this as "If I were in your shoes..." versus "I am someone different." FAS 157 refers to a principle market where assumptions should be used that someone else would use in the same situation. Rob Esson said it was somewhere inbetween with a market consistent reference exit value measured against something, with all entity-specific issues ignored. While the IAA paper discusses a well-diversified insurer, Solvency II focuses on a "healthy entity". Also, there are problems with expense inefficiencies. If a company has a higher expense than the market, then they could book lower technical provisions under this methodology by using the market expense rate. The EC said that the company's total settlement would need to be considered, which is entity-specific in a way.
- The Subcommittee needs to decide which areas to be more pragmatic, where approximations can be accepted and where to be more robust. The IAIS should first consider the best aim and then can determine where simplifications can be made.
- The EC agreed that the current estimate would be entity specific but the risk margin would be based on a market reference.
- The IAA paper on current estimates and risk margins could further develop what is meant by the risk-free discount rate and what is meant by "robust guidance". Are rules going to be needed?

### **IAIS Financial Conglomerates: Group Supervision**

The Financial Conglomerates Subcommittee has exposed a paper about group supervision for comment. Noel Giebert (France) said that the paper is more guidance than a standard and eliminates double counting of capital. Members of the Subcommittee said that the paper raises more questions than it answers and questioned whether a group RBC is needed if there is already individual RBCs and proven protection for each solo entity. Overall, the paper did not seem to receive much support from the regulators, although observers were supportive of the issue being tackled.

### **IAIS: Governance Issues**

The Governance Task Force met the prior week. Their work plan was agreed to in Dubai, with the main direction being to do a stock-take of existing governance provisions in the IAIS and more broadly. They will review standards, evaluate how far the governance issue has spread, and coordinate current Subgroup work. The Task Force's mandate is not to create documents, but to make sure the IAIS framework is robust.

### **Other Reports**

#### **IAIS Solvency Impact Assessment**

The Subcommittee was asked if it could create an impact assessment of the group's work. The Subcommittee believes this cannot be done, at least not at this time. Detailed implementation guidance and extensive knowledge of each country's current system would be needed to assess the impact.

#### **IAIS Insurance Contracts**

Rob Esson reported that the IAIS Insurance Contracts Subcommittee met in New York on March 9-10, 2007, in conjunction with an NAIC meeting. The Group of North American Insurance Enterprises (GNAIE) advocated different standards for non-life and life insurance. They suggest not discounting the non-life reserves since that cannot be done with a significant degree of certainty. If the IAIS agrees, the Cornerstones paper would need to be modified since it says the reserves should be discounted and a risk margin added. Mr. Esson added that he also expects the International Accounting Standards Board (IASB) will include discounting and risk margins in their discussion paper. That paper is expected in April/May 2007.

GNAIE will provide more information to the Subcommittee. The QIS3 in Solvency II is also creating debate on this two-model (separate life and non-life) issue.

The Subcommittee's main issue was the IASB's Discussion Paper on Fair Value Measurement and the points around the U.S. GAAP FAS 157. FASB made a presentation to the NAIC's Statutory Accounting Principles Working Group, so the IAIS Subcommittee attended that presentation. The Subcommittee discussed a draft letter on recommendations to the IASB regarding fair value. Two key issues are as follows:

- There is difficulty/uncertainty around Level 3 (no observable market) measurements. A reference entity is needed.
- The issue of "own credit standing" is being analyzed to determine if different arguments can be presented.

The Insurance Contracts Subcommittee thought it would be preferable to delay any standards about asset/liability valuation and to work on applications standards surrounding that valuation instead.

### **IAIS Solvency Glossary Project**

Subgroup chairs will review glossary documents created by the IAIS Secretariat.

### **International Actuarial Association (IAA) –**

**IAA Current Estimate & Risk Margin Paper** --The IAIS, who is the requester of the IAA paper, are making some significant comments about potential modifications to the IAA current estimate/risk margin paper based upon comments drafted by the UK. They are also going to state that they wish this paper to be exposed by the IAA longer since it is a very important document and should have broad acceptance in the actuarial communities.

**IAA Internal Models Paper**: Allan Brender (Canada) said that the IAA paper on internal models is being completely re-written to be more of a document about how to use models. The paper will be discussed at the IAA's April meeting in Mexico City.

### **Future Solvency Subcommittee Meetings**

The 2007 remaining meetings are planned as follows:

June 13–15, in London

Sept. 18–20, in Sydney 20

(Potentially change this to Sept. 17-19 since Insurance Contracts is meeting in Sydney the prior week.)

Dec. 11–13, in Paris

**Kris DeFrain, FCAS, MAAA, CPCU**  
Chief Managing Actuary – Property/Casualty  
Financial Regulatory Services  
NAIC Executive Headquarters  
Phone: 816-783-8229  
E-mail: kdefrain@naic.org

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