

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

**Summary of the Rotterdam Meeting**

**Presented to the  
NAIC's International Solvency Initiatives (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 Rotterdam Nov. 13-15, 2006. The following is an overview of the activities and reports presented to the Subcommittee:

**IAIS Solvency Subcommittee's Common Structure for the Assessment of Insurer Solvency**

Comments from the informal consultation on the *IAIS Common Structure for the Assessment of Insurer Solvency* (Structure paper) were discussed and resolved to the satisfaction of the Subcommittee. Rob Curtis, Chair of the Subcommittee, stated that the Structure paper would be exposed for formal comment on Dec. 1 with comments due Jan. 5, finalized at the January Subcommittee meeting, and then submitted to the Technical Committee in Dubai for approval. The approved paper would then be used by the Subcommittee to develop IAIS Solvency Standards. Once the Standards are developed, the Structure paper would be revised, as needed. In this way, the Structure paper is currently considered a working document, since changes might need to be made after the Standards are developed. While individual words from the Structure paper might change for sake of flow in the standards, it is expected that the principles and concepts in the Structure paper would not be modified.

The following summarizes some of the key issues concerning the Structure paper that were discussed at the meeting:

- The revised format of the paper more clearly emphasizes the key concepts of the paper.
- Since the paper is not a Principles paper, the "Supporting Principles" would be re-named as "Structural Elements".
- The list of adequate supervisory powers in Supporting Principle 1 will be modified so that it is clear that a company could choose to raise capital rather than be forced to reduce risks.
- Supporting Principle 4 and supporting paragraphs will be revised by the U.S.A. and France to be consistent with the IAIS' Second Liabilities paper and to sufficiently address appropriate comments.
- While Life and Property/Casualty differ in practice, the principles should be the same. The IASB is developing a single insurance standard, but expects that practical application will differ by line of business. Rob Curtis said that the Standards to be written by the Subcommittee should reflect that "Practical application of the Standards may differ by line of business."
- The Total Balance Sheet Approach was discussed and generally the Subcommittee believed that the IAIS has moved beyond the definition originally developed by the IAA. While the total balance sheet is important, there is also a need for the IAIS to establish technical provisions consistent with capital. The paper will be re-worded to explain that the concept is an extension of the IAA's *Blue Book*.
- There will be an explicit statement that model and parameter risk should be in both technical provisions and capital. When calculating each, there would be model and parameter risk resulting from the estimations and modeling.
- The valuation of technical provisions is still expected to be prospective and not based solely on the premiums charged. It will be noted, though, that the analysis of the prospective cost underlying the premium charged could be useful valuation information.
- Two considerations were discussed regarding the impact of diversification and whether that should be reflected in technical provisions or capital:
  - If technical provisions reflect transfer value, then would the best estimate reflect diversification if the market is made of multi-line insurers?

- If diversification is within technical provisions, does that breach the IAIS position that similar risks with similar risk profiles should result in similar liabilities?

The Standards will develop this theory. One view was that the diversification within a line of business would be in the technical provision and other diversification (e.g. when combining lines of business) would be within capital.

- The Executive Summary needs to be more narrative, but that can be done after the Standards are developed and the Structure paper is revisited.
- The introduction will be revised to reference the need for efficient, well-regulated markets in order to attract and retain capital.
- The Future Works section will be modified to reflect the Subcommittee's revised plans.
- The Subcommittee will not elaborate on tax issues.
- Future comments provided to the Subcommittee should include proposed wording changes.

### **IAIS Solvency Subcommittee's Standards & Issue Paper**

Working Groups were established to develop the following four papers:

- 1. Standard on the Valuation of Assets and Technical Provisions**
  - United States (Rob Esson, chair) with France, possibly Australia
- 2. Standard on Capital Requirements and Resources**
  - Australia (Helen Rowell, chair) and Japan, possibly Guernsey, Canada, UK
- 3. Standard on Risk Management for Solvency Purposes**
  - UK (chair), possibly US and France
- 4. Issues paper on Internal Models**
  - UK, Germany, Canada, Switzerland

The IAIS Standards should be best practices, as defined by the IAIS, but should be principles-based and at a higher level so that every time calculation methodologies are improved, the standards do not have to be updated. The goal was contrasted to work done at the IAA which is expected to define the methodologies in practice. For internal models, Rob Curtis said that it is too soon to write a Standard, so he suggested that an issues paper be developed and a Standard could be written later.

The Standard on the Valuation of Assets and Technical Provisions and the Standard on Capital Requirements and Resources will require coordination. The Subcommittee discussed whether the IAIS should set the total asset requirement, subtract the IASB technical provision (with modification when deemed necessary), and establish solvency principles with the remainder (Total Asset – Technical Provision) defined as capital. Further discussion is anticipated.

Rob Curtis suggested topics and sections from the Structure paper for inclusion in each paper. Outlines of the papers will be discussed at the Subcommittee's January meeting.

The process for development of the Standards is noted as ambitious:

- December – Working Groups develop Preliminary Outlines (1<sup>st</sup> draft)
- January – Subcommittee discuss 1<sup>st</sup> draft
- February – Working Groups develop the drafts based on Subcommittee discussion.
- March – Subcommittee discuss 2<sup>nd</sup> draft
- April/May – Working Groups modify drafts based on Subcommittee discussion and submit for Informal Consultation; Working Groups modify based on Informal Consultation
- June – Subcommittee discuss 3<sup>rd</sup> drafts
- July/Aug. – Formal consultation; Working Groups modify based on Formal Consultation
- Sept – Subcommittee discuss 4<sup>th</sup> draft and finalize
- Oct - Submission to Technical Committee for approval in Fort Lauderdale.

Mr. Esson said that he had serious reservations as to whether the U.S.A. could have full engagement from the ISIWG on that timetable. Interested parties were told they could provide their views during the process and did not have to wait for formal consultation.

## **IAIS: Governance Issues**

The IAIS Technical Committee will create a Task Force to develop high-level principles on governance issues. While the Standard on Risk Management for Solvency Purposes being developed by the Subcommittee will contain governance issues that relate to solvency, the standard will not stray into broader governance and risk management issues.

## **Solvency II Presentations**

Several presentations were made on the European Union's Solvency II.

### *Pillar I – Quantitative:*

Quantitative principles are fairly similar to past presentations and reports to the ISIWG, but some additional status was provided:

- A consultation paper on the calculation of technical provisions (CP 20) was recently released and will be exposed for a couple of months. There will be a quantitative impact study (QIS 3) on the framework and proposals in the consultation paper. Issues with calibration will also be addressed in QIS 3.
- For measurement of solvency, a cost of capital approach is being recommended. The use of cost of capital for non-life (property/casualty) long-tail is still being studied.
- As a choice to using a full-scale internal model, a standard model for the evaluation of solvency will likely be developed, using simplistic factor-based approaches, scenario-based methods, or a combination. A simplistic factor-based approach would use data readily available from the balance sheet. A more advanced scenario and risk based approach might be developed as a standard model, which would require all companies to do some modeling.

### *Pillar II – Supervisory Review:*

For the ladder of supervisory levels (similar to the RBC action/control levels), the minimum capital requirements would be Rules-based, while the higher solvency capital requirements would be Principles-based. For the higher rungs of the ladder (i.e. RBC action levels – not control levels), there would be a Pillar II adjustment (“P2 Add-on”) for risk that is not easily quantifiable. In response to whether the additional amount could be appealed by a company, especially in an adversarial legal environment, it was noted that a company would be given time to fix any identified qualitative inadequacy and an additional capital requirement would only be imposed if the company chose not to fix the problem.

Concentration risk was also discussed. Limits on investments in some countries might be maintained, at least during a transitional period. With proper measurement of risk, most seemed to believe that limits on investments would no longer be needed.

### *Pillar III – Disclosure*

It is expected that the main vehicle for getting information for supervisory reporting will not necessarily be statutory financial returns, but will be more like a solvency and financial condition report. The report would have quantitative information along with qualitative narrative that would be useful to the evaluation of internal models. For public disclosure, there are options that range from no disclosure, disclosure of only the total solvency capital requirement, to full disclosure of the components of the solvency capital requirement.

### *Group Supervision*

A framework for group supervision is being developed because it is believed to be an essential matter for efficient and effective supervision at a solo entity level, although there would need to be an appropriate balance between group and solo supervision. A group supervisor would be established and the validation of a group internal model would need to be coordinated with solo supervisors. There would need to be a legal commitment to force capital flow from the parent to the subsidiary.

Australia reported that their discussion paper in 2005 on group supervision is now a response paper, with some change in position. Attestation from the Board will be required stating that the group meets APRA (Australian supervisory) solvency requirements.

### **IAIS and Solvency II Relationship**

In reaction to a comment that a member was not comfortable supporting a position that is not in accord with Solvency II, Rob Esson asked the Subcommittee to be mindful that the IAIS Solvency Subcommittee is not a Solvency II Subcommittee. While many of the issues being addressed in Solvency II are also important issues for the Subcommittee to discuss, the IAIS consists of many nations who are not involved in the creation of Solvency II and, therefore, the IAIS needs to separately determine the best approaches for international standards. While the IAIS should be mindful to keep work moving in parallel with Solvency II to the extent possible, should the IAIS adopt a position different from Solvency II, the EU will need to consider whether to modify their methodology to be in line with IAIS Standards.

### **Other Reports**

#### *IAIS Insurance Contracts*

A discussion paper from the International Accounting Standards Board (IASB) is expected in the first quarter of 2007. The IAIS Insurance Contracts Subcommittee will begin meeting again after that release. It is possible that the meetings for that Subcommittee will occur immediately before or after this Subcommittee's meetings.

#### *IAIS Solvency Glossary Project*

The IAIS Secretariat expects to present a revised IAIS Solvency Glossary to the Technical Committee in Dubai. Additional terminology will be added and inconsistencies between the Glossary and papers written by the Subcommittee will be resolved.

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

- The IAA's Risk Margin Working Group expects to expose a paper for consultation in December. The paper will be useful to the IAIS in the development of solvency standards for technical provisions. The paper currently discusses current estimate considerations, the goals of and types of risk margins, and comparison of the Cost of Capital and Quantile solvency measurement approaches. If all goes well, a final paper is anticipated after the IAA's Spring 2007 meetings.
- An Actuarial Working Group is expected to be created to improve communications between actuaries and other groups.
- A Standard of Practice for Internal Models is being developed. A final document is expected at the next IAA meeting. Three issues in the paper are the modeling process, governance, and communication. The standard is for actuaries doing work in companies. The IAIS can use the document to develop a standard for regulation.
- The IAA will discuss a possible sequel to their "*Blue Book*".

### **Future Solvency Subcommittee Meetings**

The 2007 meetings were scheduled:

Jan. 17–19, expected in South Africa  
March 28–30, in Japan  
June 13–15, in London  
Sept. 18–20, in Sydney  
Dec. 11–13, in Paris or London

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