

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

Summary of the Sydney Meeting, Sept. 17-19, 2007

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

Joe Fritsch (NY), Kris DeFrain (NAIC) and Rob Esson (NAIC) represented the U.S.A. at the International Association of Insurance Supervisors' (IAIS) Solvency and Actuarial Issues Subcommittee meeting in Sydney Sept. 17-19, 2007. The following is an overview of the activities and reports presented to the Subcommittee:

CHAIR'S REPORT

Rob Curtis, Chair of the Subcommittee, reported on the following items:

Vice Chair

The Technical Committee accepted the application of Nobuyasu Sugimoto (Japan) as the Vice Chair for the Solvency and Actuarial Issues Subcommittee. The U.S. supported this nomination and encouraged the IAIS to promote large geographical diversification between the chair and vice chair nominations.

Small Jurisdictions

Rob Curtis said he was asked whether the solvency system being developed was proportionate to small jurisdictions. He said the papers are "aspirational" and that the standards are not written for differing size of countries, however the IAIS does not expect that all countries will be able to implement certain features. At the December meeting, the Subcommittee will discuss how in practice the work can be implemented and what is appropriate, especially for smaller members of the World Bank.

IAIS Annual Meeting

At the IAIS Annual Meeting there will be a Solvency Subcommittee information session. Rob Curtis is also leading a panel of industry representatives on the common structure for insurer solvency. He said he wanted the industry perspective on the panel rather than the supervisory perspective.

CURRENT GUIDANCE AND POSITION PAPERS

Consensus was reached to send four papers to the Technical Committee for adoption in **October 2007**:

- GUIDANCE PAPER ON THE **STRUCTURE OF REGULATORY CAPITAL REQUIREMENTS**
- GUIDANCE PAPER ON **ENTERPRISE RISK MANAGEMENT FOR CAPITAL ADEQUACY AND SOLVENCY PURPOSES**
- GUIDANCE PAPER ON THE USE OF **INTERNAL MODELS FOR RISK AND CAPITAL MANAGEMENT PURPOSES BY INSURERS**
- SUMMARY OF **IAIS POSITIONS ON THE VALUATION OF TECHNICAL PROVISIONS FOR SOLVENCY PURPOSES**

At the request of the U.S., the guidance papers now all include a preamble to note that the papers express the IAIS' current positions prior to completions of standards and that the guidance papers will be reviewed in light of future work and modified appropriately. The preamble also notes that the guidance papers are expected to form the basis of proposed standards. The preamble was created as a compromise with the U.S. rather than further formal exposure of the papers and publication of the guidance papers at the same time as the standards. The preamble is expected to be removed from the guidance papers once the standards are published.

The capital guidance paper was retitled as the "structure of regulatory capital". A **new guidance paper** will be created to address **capital resources** and will largely be based off of a previous draft of a paper entitled Suitable Forms of Capital.

Almost all of the U.S. comments were accepted on all of the guidance papers. The following are some notable changes in each of the guidance papers.

In the structure of regulatory capital guidance paper, the paper now reflects the following:

- The approach to calculate the MCR should be explainable in a court situation.
- Risk measures and time horizons would not need to be stated along with the over-all level of safety (so that the IAIS does not have a prescribed requirement of a particular methodology).
- A company's own risk and solvency assessment (ORSA) does not have to include a calculation of winding up but might be needed in some situations.
- There should be a sufficient buffer between the first capital action level (PCR) and the final MCR intervention level.
- Key Feature 5 now states that a regime needs to be explicit about how aggregation should be reflected in regulatory capital requirements.
- Criteria established for a standardized model should be consistent with the criteria for internal models.

In the enterprise risk management guidance paper, changes include the following:

- More emphasis is placed on the enterprise risk management framework being appropriate to the nature, scale, and complexity of its business and risks.
- An "audit trail" should be created so that a review of ERM can be evaluated over time.
- The annex that defined risk management characteristics was removed for potential inclusion in the application guidance.

The internal models guidance paper was re-titled to be clear that the focus is on internal models for risk and capital management purposes only. Changes to the paper include the following:

- A change in tone was achieved by the elimination of wording that "sophistication" of supervisors and insurers is a basis for the use of internal models and replacement with reference to "experience with internal models".
- The concept of needing the model to be "seasoned" was added by noting that a supervisor may evaluate a model over a few years prior to approval.
- Partial models would not only be an acceptable interim step toward a full model, but could also be a satisfactory final target for a company.

The paper stating IAIS positions on the valuation of technical provisions was also briefly discussed. The IAIS Insurance Contracts Subcommittee submitted changes to the document, which were accepted. References to the original IAIS documents would be maintained in the paper.

Germany and France asked what the purpose of the paper was and said it was a useful internal document but wondered if it made sense to publish the document given that there is still a flow of discussion regarding the IASB discussion paper. Australia supports publishing the document and believes it can be used to influence the IASB. The paper will be sent to the Technical Committee for determination of how to proceed.

Germany expressed strong opposition to the final paragraphs related to discretionary participation contracts and wanted to add that these positions were taken in an "accounting context" rather than a "solvency context". However, the U.S. said the position was not taken just in an accounting context since the Insurance Contracts Subcommittee is acting with solvency as a focus. The goal of the Insurance Contracts Subcommittee is to persuade the IASB to have public financial reporting system that could be used for regulatory solvency purposes. The paper notes that the positions were those previously taken and that discussion continues on many subjects.

FUTURE WORK

Future Standards

The U.K. has begun to draft standards on the three guidance papers being sent to the Technical Committee. Rob Curtis said the Subcommittee has options to take the key features with some linkage to make the statements flow together or with explanatory verbiage. He said that when the explanatory verbiage is included, the paper is more like a mini guidance paper. This issue will be discussed in December.

Application Guidance

The International Actuarial Association (IAA) has begun to draft practice notes to support the internal models and enterprise risk management guidance papers and future standards. The practice notes will follow the same structure as the IAIS papers, although one IAA representative noted that that was not an

Sept. 25, 2007

easy task and asked whether the structure of the IAIS papers could be modified. Drafts will be provided at the Paris meeting in December.

The IAIS will need to discuss whether to only comment to the IAA on the work, to somehow endorse the work, or to publish the work at the IAIS. The IAIS Technical Committee will be consulted on this decision. Australia noted that they see more risks than benefits of a joint project because the practice note will be detailed. They suggested that the IAIS continue to focus on what supervisors do and the IAA on what insurers do.

Structure Paper

Rob Curtis said that the Structure paper published in 2007 will disappear once the standards are written. The Structure paper is only a working paper.

Impact Assessment

Germany presented some potential survey questions to attempt to investigate supervisory (and not industry) implementation matters prior to publication of standards. The Subcommittee asked to focus on qualitative, rather than quantitative, aspects within the survey and asked for a clear picture of what would be accomplished by the survey. Initial comments on the survey questions are requested by the end of October. A revised draft survey will be discussed in December.

A first step would be for active members of the Subcommittee to voluntarily answer the survey. After that, additional IAIS members could be surveyed. Rob Curtis also said that the voluntary survey of active members might be the only approach that can be taken prior to finalizing Standards. Others said that a survey of just active members would not be a good enough representation to determine the impact.

Group Issues

An issues paper on group solvency requirements would be written to complement work in the Financial Conglomerates Subcommittee. The Financial Conglomerates Subcommittee has not yet finalized their over-arching principles because there is some contention; however the European delegates expressed interest in having the IAIS do this work.

Timelines

The Subcommittee recommendations to Technical include finalizing standards on internal models, ERM, and the structure of capital in 2008. A guidance paper on capital resources would be scheduled for 2008, with a standard to follow in 2009. A guidance paper on asset/liability valuation would be worked on jointly with the Insurance Contracts Subcommittee with a goal of publication in March 2009 and a standard later in 2009. (The U.S. said this target date should be further discussed in light of IASB considerations.) An issues paper on group solvency requirements would be scheduled for March 2009. (The U.S. again asked if that date is achievable given the difficulties of finalizing the over-arching principles.)

FUTURE MEETINGS

Tentative dates for next year's Solvency Subcommittee meetings were announced:

Feb 4-6 Malaysia

Apr 8-10 Bermuda

May 28-30 San Francisco

Sept. 9-11 Guernsey

Nov. 11-13 Bonn or Frankfurt

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