



IAIS 2012 and EU-U.S. Dialogue

Summary

As various countries are planning or implementing far-reaching changes to insurance regulation, on October 10–12, more than 600 people attended the 19th Annual Conference of the International Association of Insurance Supervisors (IAIS), the largest association of insurance regulators. The IAIS represents insurance regulators and supervisors in approximately 190 jurisdictions in nearly 140 countries, covering an estimated 97 percent of global insurance premiums. It also has more than 120 observers, including KPMG LLP(KPMG). Its objectives are to:

- Promote effective and globally consistent supervision of the insurance industry to develop and maintain fair, safe, and stable insurance markets for the benefit and protection of policyholders;
- Contribute to global financial stability.

Topics discussed at this year's conference included the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), front-line supervision, financial inclusion, financial stability, improving consumer protection, and longevity risk. In addition, a lively discussion compared and contrasted U.S. and EU insurance regulation regimes, with an eye toward the coming debate over U.S. transitional equivalence under Solvency II.



IAIS 2012 Conference

The annual IAIS conference brings together top insurance regulators from around the world to discuss cross-border insurance regulation. This year's conference was especially important because many of the world's largest insurance jurisdictions are on the cusp of significant regulatory change, for example, in the EU – Solvency II; United States – RMORSA and modified Holding Company Act; Canada – MCCSR revisions; Bermuda – Solvency II-like groups supervision; Japan – QIS activities leading to a Solvency II-type capital system; to name but a few.

At this year's conference, top insurance regulators from the Americas, the EU, Africa, and Asia-Pacific attended meeting sessions on topics such as:

- *ComFrame – Towards a Common Framework for the Supervision of the Internationally Active Insurance Groups*
- *How to Develop Tomorrow's Front Line Supervisors in the Light of Supervisory Effectiveness and Intensity*
- *Lessons from Financial Inclusion Initiatives for the Advancement of Insurance*
- *Markets in Emerging Economies*
- *Insurance and Financial Stability*
- *Improving Consumer Protection in the Area of Insurance and Pensions*
- *Longevity Risk.*

Solvency II

The conference featured continued discussion among industry and regulatory representatives concerning the ongoing delay of Solvency II – with many now pointing to a 2017 commencement rather than 2016, which some had predicted. Industry representatives are lobbying hard with this in mind.

In addition, the European Insurance and Occupational Pensions Authority (EIOPA) addressed the possibility of delinking Pillar 2 from Pillar 1 in light of disagreement among jurisdictions over these requirements. EIOPA is very keen to ensure that momentum is maintained, and delivering some of the Pillar 2 requirements while Pillar 1 is still being shaped may enable them to provide a staged delivery.

Systemically Important Institutions

Participants also saw the strongest indication yet that Recovery and Resolution Plans (RRPs) will be required from insurers deemed systemically important at an international level – so-called Global Systemically Important Insurers (G-SIIs). Notwithstanding this, it is understood that the criteria to determine G-SIIs will differ from that employed for banking institutions. Between 12–15 insurance groups most likely will be classified as G-SIIs in the first half of 2013 and G-SII status will be reviewed annually, according to the most recent consultation paper released by the IAIS. In the United States, industry insiders expect that, in addition to being declared G-SIIs, a number of U.S.-based insurance groups will be declared Systemically Important Financial Institutions (SIFIs) under the Dodd-Frank Act by the Financial Stability Oversight Council (FSOC). It is currently unclear if there will be any coordination of regulation for institutions receiving both the SIFI and G-SII designations. That said, it is expected that the impact will be similar and will include:

1. Higher capital charges
2. Enhanced supervision
3. The need to produce recovery and resolution plans.

Convergence of Insurance Regulation

As the 2011 Insurance Core Principles developed by the IAIS are adopted globally, continued convergence of insurance regulation is expected among the disparate types of insurance regulation in the world as well as between banking and insurance regulation. To this end, many jurisdictions are increasing supervision of large insurance groups under a more stringent group supervision rubric in addition to integrating the banking and insurance regulators more closely. This latter movement can be viewed in light of recent regulatory reorganizations such as that undertaken by New York, where the New York State Insurance Department was merged into the broader State Department of Financial Services; while the former is clear in the many recent discussions of SIFIs, G-SIIs, and regulatory equivalence.

At the Conference

The IAIS meetings provided regulators and industry an opportunity to discuss significant regulatory issues and related policy and risk management implications. Two main discussion points at the conference centered on ComFrame as proposed by the IAIS and systemic risk issues. Significantly, in August at a National Association of Insurance Commissioners meeting with industry representatives held specifically to discuss

the second exposure draft of ComFrame, NAIC officials made it clear that the United States and EU are far from agreement on ComFrame. Indeed, NAIC President and Florida Insurance Commissioner Kevin McCarty was quoted at the conference as saying that “ComFrame has drifted apart and everybody recognizes that.”¹ Notwithstanding the major strides made in converging cross-border insurance regulation, there is still much that remains to be done.

ComFrame

The general view in the United States that the exact purpose and structure of how ComFrame will be operationalized remains unclear. Even more, some ComFrame modules, such as Module 2’s requirements for IAIGs with respect to capital management are still too prescriptive and have caused the U.S. insurance industry to balk at supporting ComFrame as currently structured. Hope was expressed among the U.S. industry representatives at the meeting that ComFrame will embrace a more principles-based regime, which would be more palatable to companies with significant cross-border operations. To this end, Commissioner McCarty discussed whether the risk management modules of ComFrame could be advanced ahead of the capital elements and whether focus could be put on achieving supervisory cooperation and understanding rather than solvency requirements. That said, regulators and industry representatives expressed overall support for the concept of ComFrame and that it should provide a basis for supervisory convergence, coordination, and avoid duplication.

The ComFrame discussions focused on:

- The need for flexibility for approaches to ERM and support for the use of stress tests
- Acknowledgement that the group supervisor will become increasingly important and layers of subsupervision should be avoided
- Legal jurisdictional issues and how easy or difficult it may be to adopt into legislative frameworks
- The challenge of a common international group solvency assessment, particularly in the absence of an adopted international accounting standard. In addition, what capital requirement should be prescribed?
- Whether recover and resolution plans should be part of the ComFrame requirements
- Where capital is required to be held, for example, should this reside at the group level? In addition, how would any surplus capital to be transferred from one legal entity to another part of the group, especially if this is to another jurisdiction?
- The insurance supervisor’s ability to adequately monitor noninsurance entities and whether they have sufficient expertise

- Achieving economic capital efficiencies and support a growth agenda for firms to target
- Reducing the burden of regulation on firms.

Systemic Risk

Systemic risk issues continue to be on the forefront of the regulatory agenda following the financial crisis of 2007–2008. There is deep division among regulators, however, as to how to identify and mitigate systemic risk through the use of regulatory tools. Clear concerns abound over the costs and resources required should regulatory requirements follow a banking route. RRP’s persist as a sore point for regulators and industry alike as they involve a number of thorny issues, including confidentiality concerns, lack of predictive capability, and inefficient allocation of resources. Regulators have thus far provided little insight on already performed analyses of system risk as well as the future of RRP’s. As an interim measure, industry insiders believe that RRP’s should focus on recovery elements of an RRP rather than resolution mechanisms. At this point in time, the need for linkages with a global standard are hard to ignore and the current absence of a Basel-type framework (common capital requirements) puts the industry on the defensive when it comes to the FSB.

The EU-U.S. Dialogue on Insurance Regulation

The primary purpose of the EU-U.S. Dialogue is to foster mutual understanding between EU and U.S. regulators in order to find common ground for regulatory convergence. The major work of the Dialogue, so far, has focused on the creation of a factual report based on the results of the Dialogue’s seven technical committees (Professional Secrecy and Confidentiality; Group Supervision; Solvency and Capital Requirements; Reinsurance and Collateral Requirements; Supervisory Reporting, Data Collection and Analysis and Disclosure; Supervisory Peer Reviews; and Independent Third Party Reviews and Supervisory On Site Inspections). A draft report



¹ Festa, Elizabeth, “With ComFrame ‘adrift,’ discussion is centered on capital standards at IAIS meeting,” *LifeHealthPro* (October 10, 2012)

was released on September 28, 2012, with a Washington Hearing on the report on October 12 by the Steering Committee comprised of Michael McRaith, Director of FIO; Kevin McCarty, President of the NAIC; Terri Vaughan, CEO of the NAIC; Karel Van Hulle, EC Head of Unit; Gabriel Bernardino, Chairman of EIOPA; and Ed Forshaw, Manager Prudential Policy Division of the FSA and Chair of EIOPA's Equivalence Committee. The draft report is discussed in detail, below.

At the Washington Hearing, the draft report was discussed with interested parties citing the completeness, accuracy and factuality of the report as its significant strengths. At the hearing, a wide-ranging group of interested parties ranging from industry trade publications to legal firms to Lloyd's of London to EU parliamentarians expressed their views. Although regulators cautioned that the EU-U.S. Dialogue had no connection to the looming issue of U.S. equivalence under Solvency II, the report was seen as a watershed for continuing EU-U.S. discussions of U.S. equivalence under Solvency II as the report provides a basis to discuss and understand common and disparate outcomes and approaches under both systems.

Although the report identified certain significant differences in approaches to regulation between the EU and the United States—especially in the areas of reinsurance and group supervision—there was general agreement that the report provides a way forward to compare the U.S. and EU regimes based upon hard fact rather than personal feeling. Indeed, the Steering Committee as well as the interested parties commented repeatedly regarding how similar the two systems of insurance regulation are when approached from an outcomes-based perspective. Notwithstanding the congratulatory atmosphere of the hearing, it was clear through the comments of the trade associations that multinational insurers still require clarification with respect to cross-border regulation of IAIGs. Multinational insurers continue to be concerned with the time frame for any equivalence finding for the United States as well as the uncertainties surrounding the final effective date for Solvency II. The recent NAIC adoption of explicit supervisory college provisions as part of the modified Holding Company Act Model Law was seen as a major step

in harmonizing international regulation, but industry trades pleaded for more clarity going forward—a point acknowledged by Commissioner McRaith of the FIO.

Finally, not to be lost in this mix at the hearing were third-party jurisdictions hoping to be included in the future of international insurance regulation. As the EU-U.S. Dialogue is by definition a bilateral arrangement, the Bermuda Association of Insurance & Reinsurances implored the Steering Committee to utilize the EU-U.S. Dialogue as a starting point for subsequent understandings between third-party regulators rather than a tool to exclude such jurisdictions from any international level playing field agreed to by the EU and U.S.

Most representatives at the hearing reiterated the importance of the EU-U.S. relationship and the need for a common understanding (if not agreement) between the two largest insurance jurisdictions. However, it still remains to be seen where the EU and United States end up on the exceedingly important issue of U.S. equivalence. Without clarity as to these most basic issues of international cooperation, it will be quite difficult to achieve the optimal convergence of international regulation that is so vaunted by regulators and industry alike. For the moment, the path forward for large insurers remains slow but steady.

Conclusion

Although the future of international insurance regulation is still uncertain, it is being carried forward through events such as the IAIS conference and led by strong bodies such as the IAIS and the EU-U.S. Dialogue. In the past year, we have seen significant regulatory moves in the EU, the United States and around the world. As the playing field changes, it is important for companies to stay abreast of the latest developments in a wide variety of topics including ComFrame, the U.S. ORSA, European Solvency II, front-line supervision, financial inclusion, financial stability, improving consumer protection, and longevity risk. Although the world seems to be moving toward the goal of convergence, there is no doubt that it will be a slow, methodical process that will entail regulatory and other risks for both domestic and multinational players.

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