

International Insurance Foundation Annual Meeting Symposium

Risk Sensitive Solvency Measures

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New capital regimes in effect or under development

- UK
- Switzerland
- Australia
- Netherlands
- Canada
- Peru
- Thailand
- European Union
- Etc.

Regulatory Capital Initiatives

	Simple Factor	RBC-type	Internal Models (Stochastic/Scenario?)
UK		Enhanced Capital Req. (non-life)	Realistic BS (Life); Individual Capital Assessments (ICAs)
Netherlands		Dutch Solvency & Continuity Tests	Dutch Solvency and Continuity Tests
Switzerland		Swiss Solvency Test	Swiss Solvency Test
Canada		MCT/MCCSR	DCAT
EU	Solvency I	GDV Proposal	Solvency II
US		RBC	C-3 Phases 1 and 2 (plus principles-based reserving)

Why?

- Issues in insurance markets
 - Increased complexity
 - Pressure to be more capital efficient
 - Specific market problems
- Influence of broader financial services
 - Basel II
 - Conglomerates/financial convergence/integrated supervisors
 - Financial Stability Forum (FSF)

IMF/FSF criticisms

- ...Capital adequacy (is) covered at a fairly high level in the standard. Therefore, a wide range of approaches . . . are in use, some of which may be deficient. . ."
 - Financial Sector Regulation: Issues and Gaps, IMF (August 2004)
- "Particular attention needs to be paid to shortage of internationally agreed concrete capital and risk management standards in the insurance sector."
 - FSF statement, September 2004

Key Initiatives

- IASB/IFRS
- EU Solvency II
- IAIS Solvency Subcommittee

International Accounting Standards Board

- Developing International Financial Reporting Standards (IFRS)
- Discussion document for insurance contracts will be issued next year
 - Market consistent valuation of liabilities
 - Trading price/settlement values
 - Loss reserve discounting
 - Risk margin
- Numerous unresolved issues

Solvency II

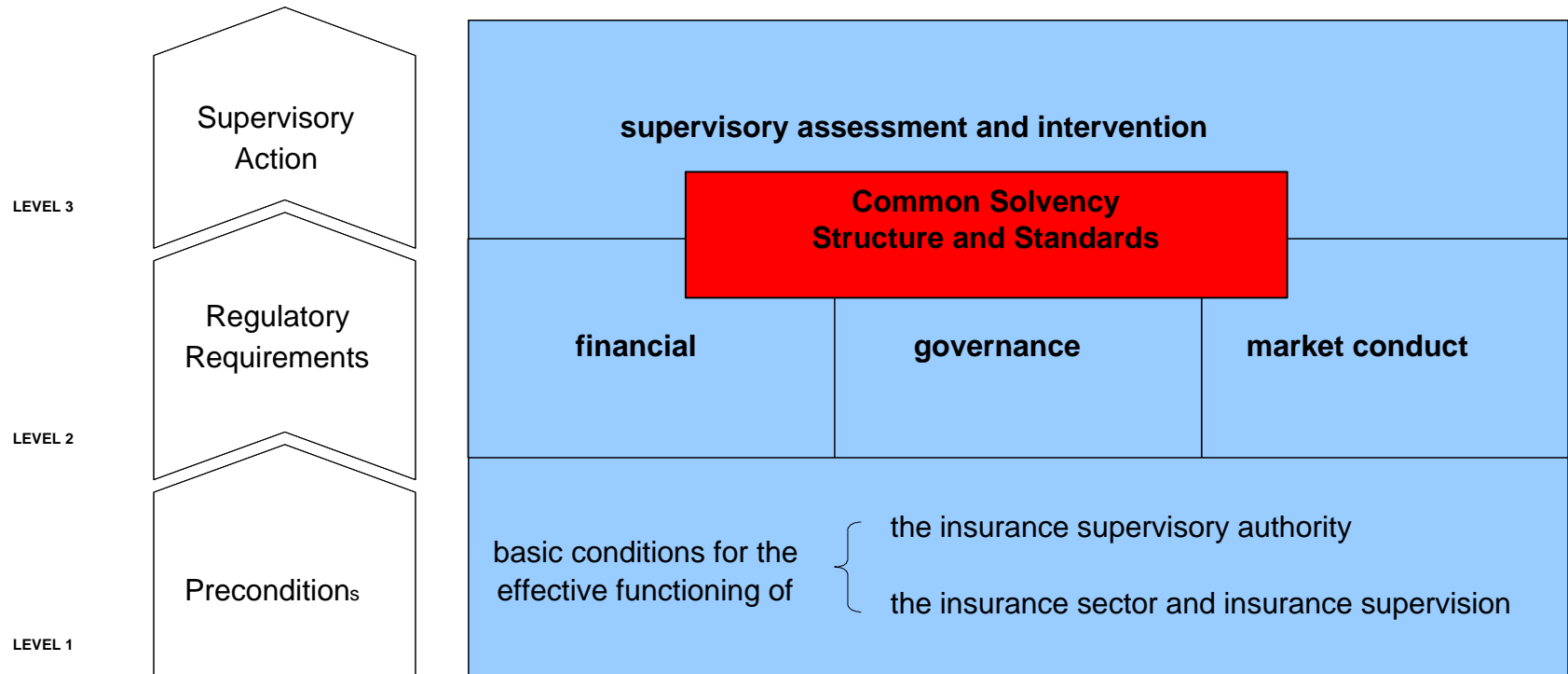
- Three pillars
 - I: Quantitative requirements to ensure capital adequacy
 - II: Internal risk management processes and supervisory review
 - III: Increased transparency
- Total balance sheet approach – broad set of risks
- Technical provisions with risk margin (Cost of capital vs. percentile approach)
- Standard approach and internal models
- Solvency control levels
- Focus on qualitative aspects of risk management in pillar II

IAIS Papers

1. **A New Framework for Insurance Supervision:**
Towards a common structure and common standards for the assessment of insurer solvency
2. **Toward a Common Structure and Common Standards for the Assessment of Insurer Solvency:** *Cornerstones for the formulation of regulatory financial requirements*
3. **Roadmap for a Common Structure and Common Standards for the Assessment of Insurer Solvency**
4. **The Common Structure for the Assessment of Insurer Solvency**

IAIS Framework Paper

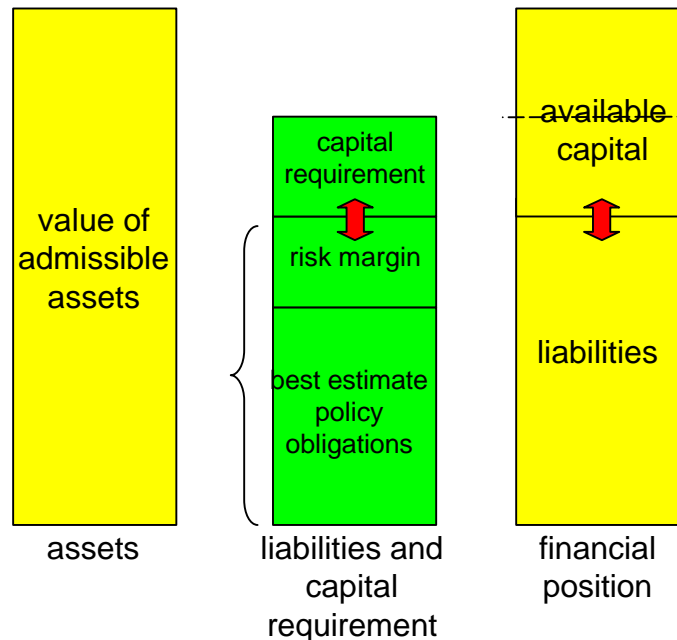
Outline of the Framework for insurance supervision



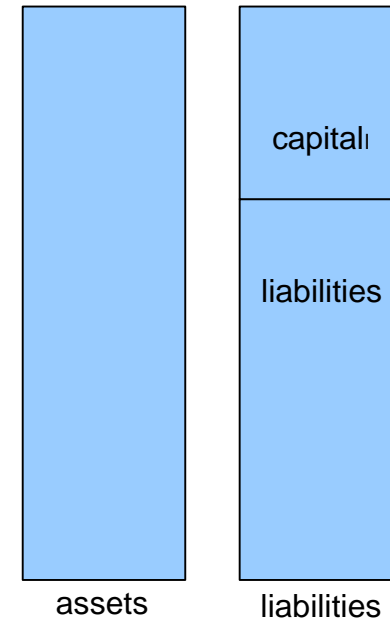
IAIS Cornerstones Paper

The supervisory assessment of the financial position of an insurer and the public financial reporting of an insurer

Supervisory Assessment of the financial position of the insurer



Public financial reporting



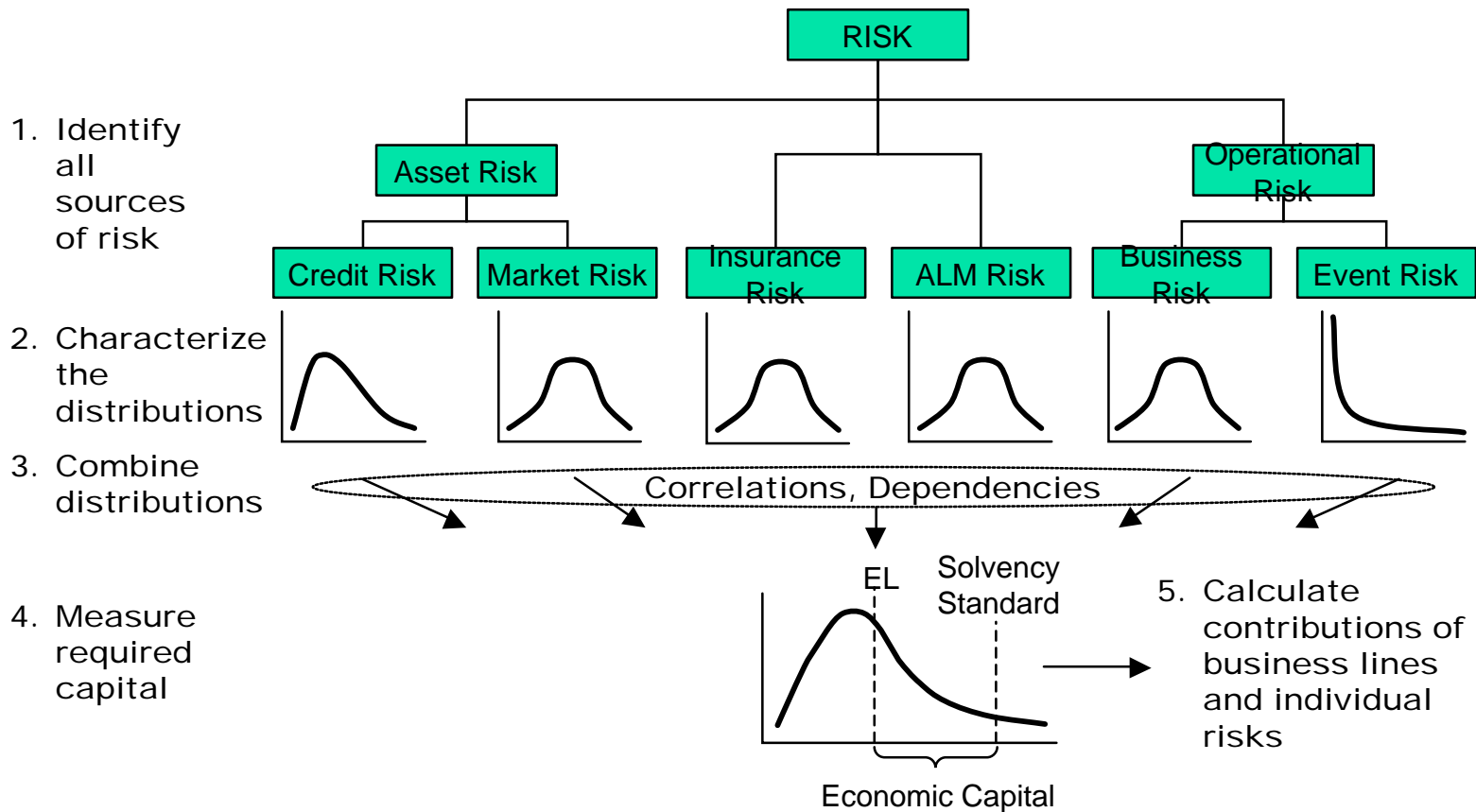
Roadmap and Structure papers

- Roadmap Paper outlines a work plan.
- First step is the development of a “Structure Paper”:
 - Elaborates on main elements of the structure, including total balance sheet approach
 - Identifies respective roles of capital and technical provisions
 - Market consistent valuation of assets and liabilities
 - Technical provisions include risk margin based on settlement value/transfer pricing; ideally consistent with IFRS
 - Draft paper issued in June. Revised draft will be issued later this fall, with comment period to follow. Intent is to have the IAIS Technical Committee adopt the paper in January.
- IAIS is working with the IAA a recommended approach for risk margins.

Common Themes

- More risk sensitive measures
- Encouraging effective risk management
- Encompassing a broader set of risks (credit, market, underwriting, and operational)
- Relevance of internal models (Stochastic modeling, scenario testing)
- Market consistent valuation of assets and liabilities
 - Consistency with IFRS
 - Risk Margin in liabilities
- Total Balance Sheet Approach
- Issues
 - Measures of variability/risk margins
 - Risk aggregation; group vs. individual company
 - Role of the actuary
 - Regulatory oversight processes

Risk Aggregation



Issues and Questions

- No deep, liquid market for insurance liabilities
- Consistency of rules vs. consistent implementation
- Implications for cost of capital, product design, investment strategy and capital markets
- Costs to implement
- Regulatory oversight
 - Expertise
 - Need for new oversight processes
 - Model validation?

Specific issues for U.S. regulation

- Influence over development of global standard-setting
- Adoption of principles-based approach in United States
- Uniform rules vs. uniform implementation
- Extraterritorial regulation in a principles-based system