Position Paper

Insurance Europe's response to EU-US Dialogue Project

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Introduction

Insurance Europe, European insurance and reinsurance federation, based in Brussels, represents through its 34 member bodies — the national insurance associations — insurance and reinsurance undertakings, which account for around 95% of total European premium income. The transatlantic relationship constitutes the largest economic relationship in the world with bilateral trade and investment in the insurance sector alone exceeding 185 billion dollars a year. Not only is close co-operation important in terms of facilitating transatlantic business, but the EU and the US together represent 74% of the global premium income. Working together, therefore, we can make an important contribution to the shape of global insurance supervision and regulation. However, our influence is beginning to wane as other international insurance markets grow and become increasingly sophisticated in their regulatory approach, therefore publication of the report is not only timely for transatlantic business flows but the international footprint of companies located both sides of the Atlantic.

Insurance Europe welcomes the technical report and acknowledges the significant work that has gone into producing it. It is a milestone in our transatlantic relationship and one we hope will lead to an enriched dialogue between supervisors continuing into the future. To the best of our knowledge, publication of a report of this nature is not only a first in the insurance sector but provides a valuable blueprint for greater supervisory and regulatory understanding which will serve as a model for other sectors and jurisdictions.

Each of the topics chosen for comparison are important; however, following a few general comments relevant to all sections of the report we will focus our comments on the following topics: i) solvency regulation, ii) group supervision, iii) reinsurance and collateral requirements; iv) consistent application of regulation and v) supervisory peer review.

General Comments

An outcome focused approach is essential when comparing two different regulatory regimes. Otherwise, differences in regulatory approach may delay meaningful progress and detract attention away from the overall goal - supervisors gaining a better and closer understanding of how different procedures and processes achieve the same aims and sufficient levels of policyholder protection. Against the backdrop of the financial crisis supervisors are increasingly looking beyond their national boundaries to safeguard the financial stability of their domestic markets and to ensure mismatches do not occur between a company's global reach and the scope of its regulatory and supervisory perimeter. Closer coordination and cooperation between supervisors is essential, otherwise the regulatory burden on insurers operating

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internationally will likely increase exponentially with duplicative and conflicting supervisory efforts resulting. The report provides a valuable basis on which greater supervisory understanding can develop and should facilitate informed decision making on where the same outcomes are already achieved through different means and identification of areas where greater harmonisation would be beneficial.

Just comparing one element of a regime without at the same time giving consideration to other mitigating or contributing factors may result in incomplete or inaccurate conclusions being drawn. It is understandable that the report must remain relatively high level; as otherwise it would become unwieldy and its readership and impact would be substantially reduced. However, it is vitally important that as far as possible key assumptions/differences in the starting points between the EU and US are not over simplified or viewed out of context. For example, a simple comparison of own funds without acknowledgement of the underlying differences between the accounting and reserving systems in the EU and US could underplay the extent of the differences in approach and exaggerate the perception of overall differences in overall policyholder protection. Therefore, the interaction between the different elements within each regime need to be recognised in order to better understand how they work together as a system. In addition, supervisory practises are often different to the aspirations of the regulation. Therefore, the practical experiences gained in supervisory colleges are an important complement to any desk research.

The report bases much of its analysis on regulatory changes yet to be implemented – Solvency II in the EU and the new model acts/laws/regulations in the US resulting from the solvency modernisation initiative. The parts yet to be finalised and then implemented will have an impact on some of the conclusions drawn in the report. The report also pre-supposes that the new requirements will be consistently implemented in both the EU and US respectively which historically has not necessarily been the case. Thus, the inclusion of information in the introductory section on tools available to achieve consistent implementation of regulatory/supervisory requirements is all the more important.

Comments on specific sections of the report

Solvency regulation

- This is one area where it is clear that the EU and US have very different approaches although their overall objective of protecting policyholders is the same. As a result to get a more complete picture of risks and make a more accurate comparison of the accounting/reserving of the different regimes it is important to take a holistic look at the total overall outcomes from the total approach i.e. not just single out one component for comparison. For example, a simplistic comparison of own funds would underplay the conservatism that exists in the US statutory accounting and reserving systems, whilst at the same time ignore the impact of the risk margin under Solvency II.

- The significant differences in philosophies behind the approaches to solvency regulation mean that it is both especially important, whilst also extremely challenging, that an outcomes based approach is taken when drawing any conclusions in this area. Both the EU and US solvency regimes have proven robust and evolved over time to serve the needs of local policyholders so before any steps to harmonise are agreed to the impact on local policyholders must be carefully considered.

- That said inclusion of this chapter in the report and further supervisory dialogue on this topic based on practical experience of supervising cross border groups is important. This should foster understanding of whether a similar level of policyholder protection is being achieved through different means. This understanding should not only feed into the approach taken to insurers operating across the transatlantic but is also key to the discussions on the IAIS's Common Framework for group supervision (ComFrame).

Group supervision

- As supervisors increasingly look beyond their national boundaries group supervision and improved coordination and cooperation between supervisors internationally are more important than ever.

- The complexities of trying to compare two regimes based in many respects on different assumptions are brought to the forefront when trying to achieve a holistic view of an entire insurance group's operations. We believe that a well operating supervisory college, led by a group supervisor with clear supervisory responsibilities is fundamental to achieving this and ultimately fostering greater reliance.

- In this respect we appreciate the inclusion of a section on supervisory colleges in the report and believe it touches on the key elements: identification of the group supervisor, roles and responsibilities of the supervisors, decision making process, and how disagreements are dealt with. However given the importance of having an efficient and effective supervisory college to support group supervision we believe the information included in the report on this topic could still be further expanded on. Other questions it would be helpful to consider include:
    1. To what extent and in what way(s) does the supervisory college take into account any unregulated subsidiaries in the group?
    2. To what extent can solo supervisors have access to information for parts of the group outside their direct supervisory control?
    3. How is membership of the supervisory college decided?

- In order for a supervisory college to ultimately foster greater reliance on the group supervision carried out by the group supervisor it is important that the group supervisor has a holistic view of all material group risks and the impact this has on the financial condition of the group as a whole.

- This is not something we believe can be achieved through a paper based report but rather through practical implementation. Once international colleges of supervisors are up and running we believe a holistic assessment of the financial condition of the group, including relevant off balance sheet items and activities conducted by unregulated entities, should form part of the initial discussion in the college. Ultimately resulting in mutual recognition of what works in practise and where the benefits of harmonisation are sufficient to justify the costs as well as recognition of areas where no change is needed.

- Supervisory colleges have a long history in Europe and a more recent history in the US. We welcome the revisions to the model holding company act and would like to see it consistently implemented and look forward to the lessons that will be learnt through its practical implementation.

- It would be remiss to mention the model holding company act without making reference at the same time to the US ORSA as it is an important and welcome element of a more comprehensive approach to group supervision in the US. The same is true in Europe where we welcome the development of the ORSA as an important risk management tool for undertakings to better understand their risk profile. However, in trying to foster greater supervisory reliance in another regimes group ORSA it is important that the ORSA does not become too prescriptive. Otherwise, insurers' ability to adapt their ORSA to best reflect their unique risk profile will be constrained and it will not achieve its original objective of encouraging firms to better understand and manage their risk over a longer time horizon.

- It is vitally important to companies operating both sides of the Atlantic that the developments on group supervision do not result in duplicative or conflicting practises developing including reporting obligations. Solo entity supervisors should rely on the information filed with the group supervisor rather than seek other means to get information on group risk issues already provided to the group supervisor.

<u>Reinsurance and collateral requirements</u>

- When taking a purely outcomes focused perspective, the area of the report where the contrast in supervisory approaches is most apparent is the approach taken to supervisory treatment of third country reinsurers.

- Whilst we acknowledge that the revised credit for reinsurance model law as adopted by the NAIC in November 2011 is a step in the right direction it is disappointing that even when a jurisdiction is deemed to be 'qualified' reinsurers from that jurisdiction still find themselves subject to a collateral rating scale in stark contrast to US domestic reinsurers.

- Despite its imperfections uniform implementation of the revised credit for reinsurance model law and regulation across the US is very important and unless this happens in a timely manner much of its potential benefit will be lost. In this respect it is disappointing that implementation is voluntary with only 11 states so far having chosen to adopt it and of these only 2 have implemented it.

- Insurance Europe would like to see equal treatment for financially secure well regulated reinsures regardless of their place of domicile with statutory collateral requirements removed. This would be in-line with the approach currently taken in the majority of EU member states and also the approach foreseen under Solvency II, whereby, reinsurance contracts concluded with third country reinsurers from equivalent jurisdictions are treated in the same manner as contracts concluded with EEA reinsurers and thus member states are prohibited from requiring the pledging of collateral.

- Supervision of reinsurance should also be risk-based with ceding (re)insurers incentivised to place their reinsurance with financially strong and well regulated reinsurers. In this respect we welcome the inclusion of information relating to the credit default risk chargers attached to reinsurance placements in the report.

- The sophisticated nature of reinsurance counterparties together with the global nature of the business transaction make this is one area in the report where we would like to see a consistent national, and preferably international, approach taken to its supervision and thus greater convergence in regulatory approach between the EU-US.

- In this respect, we believe the authority of the US TR and Treasury to enter into covered agreements with trading partners and the authority of the EU under Article 50 of the Reinsurance Directive to authorise cross border reinsurers by proposing treaties with third countries regarding reinsurance supervision is worthy of further exploration in order to achieve greater mutual recognition. Should such an approach be pursued, we believe the approach should be extended to other non-EU countries notably Switzerland, which also pursues a sophisticated risk based approach to reinsurance supervision.

Supervisory peer reviews

- Peer reviews are an important tool in driving greater supervisory convergence as well as encouraging a consistent implementation and application of regulatory requirements. To ensure lessons are learnt which can contribute to greater supervisory convergence we believe it is of much greater value if reviews are conducted by other 'peer' supervisors rather than 3rd party reviews. In addition, the costs of the involvement of third party reviewers are frequently much higher and ultimately get passed on to insurers and their policyholders. For these reasons we believe third party reviewers should only be used in limited circumstances.

Consistent application and implementation of regulation

- For insurers doing business internationally differences in approaches within national/regional systems significantly add to the frictional cost of doing business which in turn increases the insurance price for consumers.

- The introduction to the report provides a useful summary of the different tools available in the EU and US to achieve consistent implementation of regulatory/supervisory requirements. This section would also benefit from more information being provided on the practical differences between implementation approaches and the extent to which this might lead to different outcomes e.g. level of compliance.

- We recognise that in the EU consistent implementation of regulation has its foundation in law and the NAIC through its accreditation process works to achieve greater uniformity in implementation of its model laws. The paragraph on the US highlights that the NAIC has powers and tools to achieve consistent implementation. However, the report would maybe benefit from more detail being added on the range of tools at the NAIC's disposal and the circumstances in which they are used. For example, changes to the NAIC annual statement blank take immediate effect across the US as a result of all changes being based on a full consensus by all state commissioners. Another good example is the surplus lines IID list which following the implementation of the federal Dodd-Frank Act has consistent application across the US.

Conclusion

Finally we would like to conclude by again welcoming the report and the considerable work that has gone into producing it. The report provides a valuable starting point for greater understanding however it is the conversations and discussions that have gone into its drafting which are where the real benefits lie. It is through these dialogues and the improved mutual understanding gained which we hope steps towards recognition can be based.

The EU-US Dialogue Project is due to officially conclude on 31st December 2012. Rather than signifying the end of an important exercise in improved mutual understanding we hope this will mark the beginning of a better informed dialogue which will continue into the future. To these ends we hope the dialogues will not just be restricted to the topics identified in the report but be expanded to other areas such as systemic risk and resolution where greater coordination and improved mutual understanding between our two markets would also be highly beneficial.

We would like to reiterate that an outcome focused approach is essential when comparing two different regulatory regimes. The ultimate goal should be to ensure that regulation and supervision achieve sufficient levels of policyholder protection and avoid unnecessarily regulatory constraints. In some areas this might require changes to the current approach, for example reinsurance collateral arrangements, whereas in others no change might be needed or it is simply too early to say as discussions are still on-going. Through practical experience of group supervision in an international context, gaps in available information should be identified including areas where greater harmonisation may be beneficial.

Our transatlantic relationship is too important to ignore or let differences in supervisory approaches impede progress. Therefore, we look to our respective policymakers to bridge the gap between our regimes and ensure transatlantic business flows are not disrupted.

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, e.g. pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of over €1 100bn, employ nearly one million people and invest almost €7 500bn in the economy.

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