# Request for the EU-U.S. Dialogue Project

# for Public Comment on the Technical Committee Reports

# Comparing Certain Aspects of the Insurance Supervisory and Regulatory Regimes in the European Union and the United States

**Issue Date: September 27, 2012**
**Hearing dates: October 12, 2012 in Washington DC**
**October 16, 2012 in Brussels**
**Deadline for written submissions: October 28, 2012**

September 27, 2012

To Interested Parties:

The Steering Committee of the EU-U.S. Dialogue Project invites public comment on the reports of seven technical committees comparing certain aspects of the insurance supervisory regimes in the European Union and the United States. Attached is background information on the Project; details as to the nature of the specific advice sought by the committee and the means to contribute, both at two public hearings and in writing; and the draft reports themselves. Questions about the public consultation process only (not the technical matters contained in the draft reports) may be addressed to one of the two contacts listed below by October 5. The Steering Committee is appreciative of any contributions that you may provide.

Sincerely,

The Steering Committee

Contacts:

A. Thomas Finnell Jr., Senior Insurance Regulatory Policy Analyst, Federal Insurance Office, U.S. Department of the Treasury, at: tom.finnell@treasury.gov

Dr. Manuela Zweimueller, Principal Expert and External Relations Team Coordinator, European Insurance and Occupational Pensions Authority, at: Manuela.Zweimueller@eiopa.europa.eu

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## Introduction to the EU-U.S. Dialogue Project

In the EU, the European Parliament, the Council of the European Union and the European Commission (EC), technically supported by the European Insurance and Occupational Pensions Authority (EIOPA), are modernizing the EU's insurance regulatory and supervisory regime through the Solvency II Directive (Directive 2009/138/EC), in place since 2009. This so-called Framework Directive was the culmination of work begun in the 1990s to update existing solvency standards in the EU. Current work aims to further specify the Framework Directive with technical rules and guidelines, which are necessary for a consistent application by insurers and supervisors of the framework.

In the United States, the states are the primary regulators of the insurance industry. State insurance regulators are members of the National Association of Insurance Commissioners (NAIC), a standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. As part of an evolutionary process, through the NAIC, state insurance regulators in the U.S. are currently in the process of enhancing their solvency framework through the Solvency Modernization Initiative (SMI). SMI is an assessment of the U.S. insurance solvency regulation framework and includes a review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. insurance regulation.

In early 2012, the EC, EIOPA, the NAIC and the Federal Insurance Office of the U.S. Department of the Treasury (FIO) agreed to participate in dialogue and a related project (Project) to contribute to an increased mutual understanding and enhanced cooperation between the EU and the U.S. to promote business opportunity, consumer protection and effective supervision. The project is considered to be part of and builds on the on-going EU-US Dialogue which has been in place for over 10 years. The work is carried out in collaboration with EIOPA and competent authorities in the EU Member States, and with state insurance regulators and the NAIC in the United States. The objective of the Project is to deepen insight into the overall design, function and objectives of the key aspects the two regimes, and to identify important characteristics of both regimes.

Project Governance and Process: The Project is led by a six-member Steering Committee comprised of three EU and three U.S. officials, as follows:

- Gabriel Bernardino – Chairman of EIOPA
- Edward Forshaw – Manager in the Prudential Policy division, UK Financial Services Authority, and EIOPA Equivalence Committee Chair
- Karel Van Hulle – Head of Unit for Insurance and Pensions, Directorate-General Internal Market and Services, EC

- Kevin M. McCarty– Commissioner, Office of Insurance Regulation, State of Florida, and current President of the NAIC

- Michael McRaith – Director, FIO, United States Department of the Treasury

- Therese M. (Terri) Vaughan – Chief Executive Officer, NAIC

Since the Project began, the Steering Committee has held several face-to-face meetings in Basel, Washington DC and Frankfurt, as well as numerous conference calls. In a first step, the topics to be discussed were agreed upon and a process for information exchange under confidentiality obligations was established. The Steering Committee agreed upon seven topics fundamentally important to a sound regulatory regime and to the protection of policyholders and financial stability. The seven topics are:

- Professional secrecy/confidentiality;

- Group supervision;

- Solvency and capital requirements;

- Reinsurance and collateral requirements;

- Supervisory reporting, data collection and analysis;

- Supervisory peer reviews; and

- Independent third party review and supervisory on-site inspections.

A separate Technical Committee (TC) was assembled to address each topic. Each TC was comprised of experienced professionals from both the European Union as well as the United States, specifically, from FIO, the EC, the NAIC and EIOPA, as well as representatives from state insurance regulatory agencies in the United States and competent authorities of EU Member States. The various professionals who comprised the technical committees were selected because of their qualifications and experience with respect to the subject matter of each topic, including insurance regulators and supervisors, attorneys, accountants, examiners, and other specialists. The teams worked jointly to develop objective, fact-based reports intended to summarize the key commonalities and differences between the Solvency II regime in the EU, and the state-based insurance regulatory regime in the United States. Supporting documentation, e.g., regulations, directives, and supervisory guidance, was exchanged as requested by either side.

The accompanying seven technical committee reports have been jointly drafted and reflect the consensus views of each respective technical committee's members. No action has been taken by the governing bodies of the organizations represented on the Steering Committee to formally adopt the draft factual reports and thus this document should not be considered to express official views or positions of any organization. The reports represent the culmination of the initial work from the first phase of the Project. The reports are being exposed for

interested party analysis and comment and will inform discussions and conclusions reached by the Steering Committee on each topic during the second phase of the Project. It is envisaged that the second phase of the Project will involve discussions of the Steering Committee about the key commonalities and differences between the two regimes and will lead to policy decisions by their respective organizations regarding whether and how to achieve further harmonization in regulation and supervision. The project is scheduled to come to a conclusion by December 31, 2012.

## The Consultation Process

The Steering Committee welcomes public input with respect to the TC reports. Public hearings will be held in Washington DC on 12 October 2012 and in Brussels on 16 October 2012 to provide an opportunity for interested parties to bring comments forward as to the following:

- Accuracy – Are the TC reports factual and accurate?

- Completeness – Are the TC reports sufficiently comprehensive/complete, i.e., do they contain all of the key aspects of the insurance regulatory/supervisory regimes in the EU and the United States with respect to each topic? Have any key areas regarding those topics been omitted?

- Classification – Are the key aspects fairly classified in each TC report as being either a commonality or a difference between the (re)insurance regulatory and supervisory regimes in the EU and the U.S.?

- For each topic, whether the different supervisory regimes should move to convergence or improved harmonization and, if so, how should that convergence or harmonization occur? Or, if not, what alternative is suggested?

For all who plan to attend one of the hearings, please note the following:

- If you would like to speak during the hearing on October 12, 2012 or the hearing on October 16th, you must provide notice in advance of your desire to speak during the hearing not later than close of business on October 10, 2012. Notice should be sent by e-mail to those indicated in the following chart for the respective hearing.
- In addition, the organizations that are handling the meeting planning aspects for the hearings (the NAIC for the October 12, 2012 hearing in Washington DC and the EC for the October 16, 2012 hearing in Brussels) require advance registration of all attendees, whether or not they intend to speak at the hearings. This is for purposes of venue planning as well as building access. Registration information is available on the NAIC web site for the hearing to be held in Washington DC and on the EC's web site for the hearing to be held in Brussels – see the following chart for the respective e-mail /URL addresses to register your planned attendance.
- Commenters will be limited to 10 minutes each. The Steering Committee may, in its sole discretion, reduce that limit further depending on the number of interested parties that register in advance their intent to provide oral comments.
- Because of the time limit, interested parties may want to supplement their oral testimony with a written submission, which will be accepted if received no later than close of business on October 28, 2012 by e-mail to: EUUSProjectReport@eiopa.europa.eu.

- For interested parties who do not wish to attend one of the hearings, their written submissions are welcomed and will be accepted if received by close of business on October 28, 2012 by e-mail to: EUUSProjectReport@eiopa.europa.eu.
- Comments will be available at https://eiopa.europa.eu/consultations/public-hearings/index.html as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Electronic submissions are required.

The time and locations of the two public hearings are as follows:

| Date and Time | Friday, October 12, 2012<br><br>2-5 PM EST | Tuesday, October 16, 2012<br><br>Registration: 9:30-10:00AM<br>10:00AM to 1:00PM |
|---|---|---|
| Location | Grand Hyatt Washington<br>1000 H Street NW,<br>Washington, D.C., USA 20001<br>Room number: Independence Room F-I; In case of a last-minute change, the room number will also be posted at the IAIS meeting registration desk. | Centre de Conférences<br>Albert Borschette<br>36 Rue Froissart, 1040 Brussels<br>Room 1C |
| To register to attend (required for all attendees, whether or not they intend to speak) | Send e-mail with your name and company/ organization affiliation to: useuprojecthearingdc@naic.org | Please use the following link (to be available beginning 1 October 2012) to access the online registration form for the public hearing to be held in Brussels:<br><br>http://ec.europa.eu/internal_market/insurance/solvency/latest/index_en.htm |
| To register to speak at the hearing | Send e-mail with your name and company/ organization affiliation and indication of your desire to speak to: tom.finnell@treasury.gov | Send e-mail with your name and company/ organization affiliation and indication of your desire to speak to: Manuela.Zweimueller@eiopa.europa.eu |

Members of the Steering Committee will be present at both public hearings to receive and listen to comments. It is not anticipated that there will be a formal presentation by the Steering Committee, nor does the committee intend to discuss at the hearings any comments received. Similarly, it is not anticipated that the Steering Committee will issue a written response to comments submitted either at the hearings or in writing. However, it is anticipated that the

seven technical committee reports will be corrected for any factual errors or omissions that are identified during the public consultation process and will then be posted as a final version on EIOPA's website at https://eiopa.europa.eu/consultations/public-hearings/index.html and on the NAIC's website at http://www.naic.org/committees_g.htm.

The information that is the subject of the accompanying seven reports pertains to the insurance regulatory and supervisory regimes in both the EU and the United States.

In the case of the EU, the approach described in this report is largely based on the approach set out in the Solvency II Directive. However, in order to ensure a comprehensive comparison with the State-based Regime in the U.S. reference is also made in some cases to the approach envisaged for the technical rules that will implement the Directive. It is important to note that those technical rules are still under development and have yet to be adopted by the European Commission in the form of delegated acts. The report does not purport to represent or pre-judge the views and/or the formal proposals of the Commission. The approach described is largely based on what was tested in the last full quantitative impact study (QIS5), the technical specifications for which are publicly available.

Insurance is a specialized and complex industry, and insurance regulatory and supervisory matters can be just as specialized and complex. Terminology used in the reports reflects the background of the respective members of each technical committee, and thus the terminology and writing styles may vary somewhat from one committee report to another. The Steering Committee expects that interested parties who may have an interest in the Project and in submitting comments are familiar with the insurance industry and its regulation in the EU, the U.S., or both. Accordingly, the technical committees have endeavoured to prepare their reports in a manner that is appropriate for their own purposes and that of the Steering Committee.

There is some technical terminology that is used in the reports and, where considered appropriate, definitions have been provided therein: Some terms are unique to the U.S. and the E.U. but have the same meaning, for example: insurers and undertakings; and reserves and technical provisions. Other terms exist in both the U.S. and the E.U., e.g., review, audit or ORSA, but differ in content/substance.

Numerous abbreviations and acronyms have been used throughout the seven reports, definitions of which have been included in a separate appendix for the convenience of readers.

The text of this report can be quoted but only with adequate attribution to the source document.

## The Contributing Parties

### The Federal Insurance Office, U.S. Department of the Treasury

The Federal Insurance Office (FIO) of the U.S. Department of the Treasury was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The FIO monitors all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system. The FIO serves on the U.S. Financial Stability Oversight Council. The FIO coordinates and develops U.S. Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors. The FIO assists the Secretary in negotiating certain international agreements, and serves as the primary source for insurance sector expertise within the Federal government.

The FIO monitors access to affordable insurance by traditionally underserved communities and consumers, minorities, and low- and moderate-income persons. The FIO also assists the Secretary in administering the Terrorism Risk Insurance Program.

### The European Commission

The European Commission (EC) is one of the main institutions of the European Union. It represents and upholds the interests of the EU as a whole. The EC is the executive branch of the EU and is responsible for proposing new European laws to Parliament and the Council. The EC oversees and implements EU policies by enforcing EU law (together with the Court of Justice), and represents the EU internationally, for example, by negotiating international trade agreements between the EU and other countries. It also manages the EU's budget and allocates funding.

The 27 Commissioners, one from each EU country, provide the Commission’s political leadership during their 5-year term.

### The National Association of Insurance Commissioners

The National Association of Insurance Commissioners (NAIC) is the standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight that is exercised at the state level. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national regime of state-based insurance regulation in the United States.

## European Insurance and Occupational Pensions Authority

The European Insurance and Occupational Pensions Authority (EIOPA) was established as a result of the reforms to the structure of supervision of the financial sector in the European Union. The reform was initiated by the EC, following the recommendations of a Committee of Wise Men, chaired by Mr. de Larosière, and supported by the European Council and Parliament. EIOPA technically supports the EC, amongst others, in the modernization of the EU's insurance regulatory and supervisory regime. Current work aims to further specify the Solvency II Framework Directive with technical rules and guidelines, which is necessary for a consistent application by insurers and supervisors of the framework. In cross-border situations, EIOPA also has a legally binding mediation role to resolve disputes between competent authorities and may make supervisory decisions directly applicable to the institution concerned.

EIOPA is part of the European System of Financial Supervision consisting of three European supervisory authorities, the others being the national supervisory authorities and the European Systemic Risk Board. EIOPA is an independent advisory body to the EC, the European Parliament and the Council of the European Union.

EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

## Other Contributing Parties

The Steering Committee of this Dialogue Project gratefully recognizes the contributions of their organization's staff, of insurance supervisors and regulators from various EU Member States as well as from various state insurance departments in the United States who served on the various technical committees. Those individuals are listed in Appendix II.

## The Technical Committee Reports

In developing their reports, the Technical Committees acknowledged the overall policy objectives of insurance regulation, the protection of policyholders. Both regimes aim to ensure the ongoing solvency of domestic insurance and reinsurance companies. Additional regulatory objectives include facilitating an effective and efficient marketplace for insurance products, and ensuring financial stability. These overarching policy objectives – which are common to both the state-based regime in the U.S. as well as the EU regime – provide a foundation for each of the accompanying seven reports.

In addition, the Technical Committees were mindful of the regulatory framework of both regimes. The state-based solvency regime in the U.S. is based on 7 core principles, as follows:

- Principle 1: Regulatory reporting, disclosure and transparency
- Principle 2: Off-site Monitoring and Analysis
- Principle 3: On-site Risk-focused Examinations
- Principle 4: Reserves, Capital Adequacy and Solvency
- Principle 5: Regulatory Control of Significant, Broad-based Risk-related Transactions/ Activities
- Principle 6: Preventive and Corrective Measures, including enforcement
- Principle 7: Exiting the Market and Receivership

The EU Solvency II follows a three pillar approach.

- Pillar I: Quantitative requirements relating to valuation of assets and liabilities, including technical provisions, the quality of own funds and Minimum and Solvency Capital Requirements
- Pillar II: System of Governance and risk management requirements
- Pillar III: Supervisory reporting and public disclosure

There are commonalities as well as differences between the Core Principles identified in the U.S. state-based regime's Insurance Financial Solvency Framework and the three pillar approach of Solvency II. The reports of the Technical Committees which follow highlight the key commonalities and differences for each of the seven topical areas selected for them by the Steering Committee to review.

Each technical committee focused on only one of the aforementioned topics. In practice, the regulatory aspects that are the topic of each respective technical committee report operate on an integrated basis, as well as with other regulatory tools and powers that are not covered by the accompanying reports. Where appropriate, the report of a technical committee makes reference to the reports of one or more other technical committees. For example, a reference in any one of the accompanying reports to "TC3" means the report of Technical Committee 3, which is listed in the Table of Contents of this combined document as "3. Solvency and Capital Requirements."

The reports of the technical committees refer to various EU directives and regulations, as well as to various NAIC model laws and regulations. In the EU, a directive is a legal act that lays down certain end results that must be achieved in every Member State. National authorities have to adapt their laws to meet these goals, but are free to decide how to do so. In case of maximum harmonization directives, Member States may not foresee requirements other than those laid down by the Directive.[1]

EU regulations are the most direct form of law; as soon as they are passed, they have binding legal force throughout every Member State, on a par with national laws. National governments do not have to take action themselves to implement EU regulations. Regulations are passed either jointly by the Council of the European Union and European Parliament, or in some specific areas, by the Commission alone.

The state-based regime in the U.S., through the NAIC, utilizes model laws and regulations developed by state insurance regulators. Although these model laws and regulations require state legislative enactment to become effective, a core set of solvency regulation standards are effectively obligatory by operation of the NAIC Accreditation Program. Although the states are primarily responsible for the regulation of insurance in the U.S., certain federal laws referenced herein may also apply to insurers or specific insurance activities.



[1] The Solvency II Framework Directive is considered for major parts a maximum harmonization directive.

## 1. Professional Secrecy and Confidentiality

**Executive summary**

- TC1 organised its analysis of the key commonalities and differences by focusing on the analysis of the following subjects: policy objectives of confidentiality laws; the relationship between freedom of information laws and insurance confidentiality laws in the U.S. and the EU; the role of the National Association of Insurance Commissioners (NAIC), the European Insurance and Occupational Pensions Authority (EIOPA) and the Federal Insurance Office (FIO) as distinct from insurance regulators / supervisors in the U.S. states and EU Member States; authority to share information across borders and the laws associated with information exchanges, methods for exchanging information, such as Memoranda of Understanding (MoUs) and confidentiality agreements, and the confidentiality of non-public supervisory information received by the FIO.

- Both regimes seek to balance the objective of maintaining professional secrecy with appropriate flexibility to share information with other supervisory authorities with a legitimate and material interest in the information. Against this key commonality, key differences in structural approach can be observed. In the EU, the basic presumption incorporated in insurance legislation is that virtually all information acquired by the supervisory authorities in the course of their activities is bound by the obligation of professional secrecy. A series of "gateways" then facilitates information exchange with other relevant authorities. In the U.S., state laws generally provide for the confidentiality of certain information submitted to, obtained by, or otherwise in the possession of an insurance department. The approach is more often focused on protecting specific information from being available for public inspection.

- Freedom of information (FOI) laws concerning government records and actions are premised on public access to official actions. In both the EU regime and the state-based regime in the U.S., laws express the general policy of public access to government information, but this public policy is qualified by specific protections from disclosure for certain categories of information. The result is that both regimes provide for broad confidentiality protections for sensitive information while allowing for the sharing of that information among regulators in appropriate circumstances.

- In both regimes, primary regulatory responsibility rests with the various state insurance departments in the U.S. and with the EU Member State supervisory authorities, respectively. The functions of both sets of supervisors are supplemented by the NAIC in the U.S. and EIOPA in the EU. The NAIC and EIOPA, in varying ways, assist the supervisory authorities in their regulatory roles and, in doing so, may receive certain confidential information pursuant to the laws of the relevant jurisdictions.

- The newly-created FIO establishes a center of insurance expertise within the U.S. federal government. In carrying out certain of its functions, FIO will continue to interact with insurance and other regulators in the U.S. and the EU, and may participate in exchanges of confidential information. The Dodd-Frank Act requires the FSOC, the FIO, and the Office of Financial Research (OFR), which is an office within the U.S. Department of the Treasury that was also established by the Dodd-Frank Act, to maintain the confidentiality of any data, information, and reports submitted under that Federal law. All FSOC members entered into a MoU that sets out the understanding of all FSOC members regarding the treatment of non-public information. The MoU presumes that non-public information exchanged under its terms is confidential.

- Both regimes include general authorizations to share confidential information with other financial regulators, law enforcement officials and other governmental bodies in need of such information to perform their duties. Confidential information may only be disclosed to such persons if they can maintain confidentiality and/or demonstrate their ability to protect such information from disclosure when the information is in their possession. Both regimes acknowledge the possibility of utilizing and disclosing information in receivership and bankruptcy actions, prosecuting regulatory and criminal actions, and pursuant to certain court actions.

- Both regimes allow for regulators to enter into agreements or MoUs with counterparts in other jurisdictions to facilitate the sharing of confidential information. Both regimes provide broad discretion to regulators to establish the terms of such agreements, including the verification of each regulator's ability to maintain the confidentiality of information received from another jurisdiction. Both regimes address the issue of potential sharing of information with third parties, but achieve similar outcomes in different ways. EU Member State requirements that the recipient of confidential information obtain explicit permission from the originating source before sharing with another regulator are often developed as a result of legal constraints under the EU directives, while state insurance regulators in the U.S. are bound by general legal requirements to respect the confidentiality of information under the laws of the providing jurisdiction and the memorialization of this respect in written confidentiality agreements.

- The similarities between the two regimes are greater than anticipated prior to the beginning of this dialogue. While there may be differences in the form and application of professional secrecy and confidentiality laws between the two regimes, they are substantially similar in the subject matter addressed and the outcome to be achieved. It is acknowledged on both sides that there is little evidence of practical problems related to the exchange of confidential information between state insurance regulators in the U.S. and EU regulators, although the flow of information has not been substantial so far and may have been inhibited by the interaction of EU directive constraints and concerns over professional secrecy.

**Topic 1:** Policy objectives in relation to professional secrecy and the exchange of information

***Key Commonalities:***

- Neither regime includes a single, all-encompassing definition of the term "confidential information." However both regimes identify general or specific categories of information that will be considered confidential by law and not subject to disclosure except under specific defined circumstances.

- Legal sources, as primarily expressed through statutes and directives, provide the foundation for the confidentiality of certain categories of information and the circumstances under which confidential information may be used and disclosed. While statutes and directives provide the foundation, both regimes recognize that confidentiality requirements may be complemented through administrative regulations, judicial opinions and MoUs.

- Both regimes provide a range of penalties that may be levied against persons who breach professional secrecy obligations. Under both regimes, the penalties can include loss of employment, civil and administrative fines, imprisonment or a combination of these penalties. The definition of the penalties, as well as their enforcement, is handled at the U.S. state or EU Member State level.

***Key Differences:***

- The structural approach to confidentiality is very different. The EU approach starts from the presumption of confidentiality and identifies exceptions. Within the U.S., the provisions on professional secrecy vary from state to state as there is a clearer emphasis on access to public records. The presumption in most cases is that information is publicly available unless it is designated confidential through state laws or statutes. However, both regimes tend toward the same outcomes in terms of protecting information identified as confidential while facilitating information exchange among supervisory authorities across jurisdictions.

***Discussion/ Description of the Two Regimes:***

- ***The EU Approach:***

The Solvency II Directive provisions on professional secrecy reflect similar provisions in the EU insurance directives currently in force. These operate on the basis that any confidential information received in the course of the performance its duties by the supervisory authority shall not be divulged to any person or authority whatsoever, except in summary or aggregate form, such that individual insurance and reinsurance undertakings cannot be identified. There are limited exceptions to the general rule, covering cases covered by criminal law and

disclosure where a firm has been declared bankrupt or is being compulsorily wound up. The professional secrecy obligation continues to apply after employees have left the supervisory authority, and the obligation also applies equally to auditors and experts acting on behalf of the supervisory authority.

While there is no definition incorporated in either the existing EU directives or Solvency II of what constitutes confidential information, the interpretation of the scope of the professional secrecy provision has been wide ranging. It is generally taken to encompass all firm specific information received by supervisory authorities unless it is already in the public domain and not just information that might be explicitly labeled confidential. Supervisory assessments of firms undertaken by national supervisory authorities are not disclosed, and the public availability of information on the performance of insurers under the existing directives will vary from EU Member State to Member State depending on provisions in national legislation. By contrast, the Solvency II regime will incorporate provisions requiring a higher level of public disclosure of financial information across the EU, including the requirement on firms to report annually on their solvency and financial condition.

A common professional secrecy provision means that there is no legal block to the exchange of confidential information between national supervisory authorities within the EU, and facilitates the participation in EU colleges. No further cooperation agreements are required, but in practice colleges often develop their own MoU to formalise the expected information exchange in respect of the particular group.

- ***The Approach in the State-based Regime in the U.S.:***

State insurance laws include many specific references to the types of information that will be considered confidential, and notably state laws generally provide that examination work papers and related information, risk-based capital information and holding company act filings and examination information are confidential. Nevertheless the extent of the availability of firm specific information in the public domain can help reinforce market discipline.

The obligation of professional secrecy on the employees of state supervisory authorities is applied through various means. State laws generally declare that confidential information shall be maintained as confidential, and confidential information shall not be disclosed except as authorised by state law. However, the professional secrecy obligation on the employees of state supervisors can also be applied, or supplemented, by employment law provisions, contractual obligations or the internal rules of the state supervisor. In many states, public employee obligations and penalties particularly focus on the disclosure of confidential information for personal gain.

In some U.S. states, the law clearly states that confidentiality obligations follow public employees upon departure from public services. In other U.S. states, the statutory obligation is less explicitly expressed although general requirements to maintain confidentiality and professional obligations appear to achieve the same outcome. Auditors and experts acting on

behalf of the state supervisory authority are equally covered by the obligation of professional secrecy as direct employees of the authority. More generally, both the EU and U.S. regimes recognize that professionals such as lawyers, actuaries, accountants and auditors are subject to professional and ethical codes independent of those laws and regulations specifically concerning the regulation of insurance. Professionals may be subject to a range of professional sanctions, including the loss of licensure, for breaching confidentiality obligations applicable to their positions.

While the variation in the structure of state laws dealing with confidential information and professional secrecy could be perceived potentially to inhibit information exchange among state supervisory authorities in the U.S., this issue has been addressed with the Master Information Sharing and Confidentiality Agreement developed under NAIC auspices.[2] One of the standard clauses of the agreement states that the state insurance regulator requesting or obtaining confidential information from another is obliged to protect the information from disclosure "at least to the same extent the Confidential Information is protected from disclosure under the laws applicable to the Responding Department, and further agrees to take all actions reasonably necessary to preserve, protect and maintain all privileges or other protections from disclosure related to such Confidential Information."

**Topic 2:** The inter-relationship of FOI provisions with professional secrecy provisions

***Key Commonalities***:

- The relationship between EU Member State FOI provisions and Solvency II, as well as the relationship between state FOI laws and confidentiality protections in the U.S., results in similar environments for information identified and maintained as confidential. The FOI principle is an essential element of appropriate public access to government information but general grants of confidentiality exempt from disclosure confidential information acquired by the supervisory authority.

***Key Differences:***

- Under topic 1 the stronger emphasis on access to information in the US was noted. For the state-based regime in the U.S., FOI provisions (with variations from state to state) potentially provide broader access to supervisory information, but those same laws also provide general and specific confidentiality protections for certain supervisory information. One notable difference from this approach is that EU law does not enumerate the specific types of information that will be exempted from disclosure but expresses it in a more general way. While state laws in the U.S. may categorize certain items of information as confidential, such as examination work-papers, EU law

[2] Sets out the rules and procedures to be observed for the purpose of information sharing and exchange among U.S.state supervisors. The insurance departments of all 50 U.S. States, the District of Columbia, Puerto Rico and Guam are parties to this master agreement.

imposes a general obligation of professional secrecy on public employees and broadly exempts confidential information from disclosure.

***Discussion:***

- ***The Approach in the State-based Regime in the U.S.:***

State freedom of information (FOI) laws in the U.S. generally provide that the public policy of the state is for access to public records and other information concerning the official activities of public employees and officials. State laws provide for a range of exceptions to the disclosure requirements contained within the state FOI law. These exceptions may be expressed as specific exceptions within the FOI law, specific exceptions within another section of the statutory code (e.g., the state's insurance code) that directly cross reference the state FOI law, or specific declarations in the state insurance code that certain information shall be considered confidential by law thereby indirectly excepting the information from the scope of the FOI law.

State insurance laws include many specific references to the types of information that will be considered confidential. It has already been noted that state laws generally provide that examination workpapers and related information, risk-based capital information, and holding company act filings and examination information are confidential. In addition to specific references, state FOI laws and insurance laws include general references to categories of information that are to be considered confidential by law and not subject to subpoena. These general references include trade secrets, competitive information, and information provided or disclosed under an expectation or agreement of confidentiality.

State insurance laws generally provide for the commissioner to share confidential information pursuant to statutory authorization. The gateways for sharing confidential information will be detailed in another section of this paper. State insurance laws generally provide that, as a condition to sharing confidential information with other governmental entities, the commissioner may be required to enter into a written agreement for that purpose and the receiving party must have the authority to maintain the confidentiality of the information provided. Similarly, state insurance laws generally provide that the commissioner may receive confidential information from other sources, including other regulators, and that such information will be maintained as confidential (and thus beyond the scope of the state FOI laws) if it is provided with the notice or understanding that the information is confidential under the laws of the providing jurisdiction. In some cases, the ability to receive and maintain confidential information from another source will be stated generally, either in the FOI law or the insurance code; in other cases, states receive this authority through specific insurance code references such as those contained within the examination or holding company law.

There is no single statutory framework to information sharing and confidentiality among U.S. states, but this does not create a barrier to confidential information sharing. Some states rely on a general legal authority to share and maintain confidential information, while other states may derive such authority from more specific (including subject-matter specific) provisions in

their statutes. Many state laws provide for a combination of general and specific confidentiality protections. Although there may be some variance in specific legal provisions, state FOI laws and state insurance laws operate together to preserve the public policy of open government and protect sensitive information from inappropriate disclosure.

- ***The EU approach:***

FOI laws and confidentiality protections operate similarly in the EU. Member State laws generally provide for access for information related to the public administration of laws, but analogous provisions providing for the confidentiality of sensitive information often are stated in more general terms. Member State laws typically state that virtually all information acquired by the regulator in course of its supervisory work will be deemed confidential by law. This general grant of confidentiality is embedded in the existing EU core insurance legislation – the Reinsurance Directive, Consolidated Life Directive and Third Non-Life Insurance Directive[3]. The professional secrecy and information sharing provisions in Solvency II are substantially similar, and requires that information acquired by a supervisory authority and its employees will be considered confidential and may not be disclosed except as specifically provided.

Solvency II provides for the circumstances and where applicable procedural requirements for disclosing confidential information with what it identifies as permitted recipients. These are the exceptions to the obligation of professional secrecy. The details of specific gateways for information sharing are covered under Topic 4 in this paper, but Solvency II states that the obligation of professional secrecy does not preclude the sharing of information with supervisors in other EU Member States. Information sharing agreements, such as MoUs, may be concluded with supervisors in non-EU countries provided the information to be disclosed is subject to equivalent guarantees of professional secrecy and the information is intended for use in the performance of supervisory duties in that country. This would include evidence and/or commitments that confidential information would not become subject to disclosure through operation of a FOI law in a non-EU country.

**Topic 3:** Relationships with national/regional bodies (*i.e.*, EIOPA, NAIC, FIO)

***Key Commonalities***:

- In the U.S. and in the EU, primary regulatory responsibility rests with the U.S. state insurance departments and the EU Member State supervisory authorities, respectively. The functions of both sets of supervisors are supplemented by the NAIC in the U.S. and EIOPA in the EU. The NAIC and EIOPA, in varying ways, assist the supervisory authorities in their regulatory roles and, in doing so, may receive certain confidential information pursuant to the laws of the relevant jurisdictions. The FIO

[3] Art. 26 of the Reinsurance Directive; Art. 16 of the Consolidated Life Directive (2002/83/EC); Art. 16 of the Third Non-Life Directive as amended (92/49/EEC)

monitors all aspects of the insurance industry, serves on the Financial Stability Oversight Council and coordinates and develops U.S. Federal policy on prudential aspects of international insurance matters. In carrying out certain of its functions, FIO will continue to interact with regulators in the U.S. and in the EU and will participate in exchanges of confidential information.

***Key Differences***:

- Under the EU regime, EIOPA has the task of contributing to a common supervisory culture by ensuring consistent, efficient and effective application of relevant legislation, and has a particular role in EU colleges where it participates as a competent authority in its own right. In the U.S., the NAIC is not considered a supervisory authority although it coordinates certain activities among state supervisors and provides a series of analytical and support services. In both regimes, EIOPA and the NAIC may have access to firm-specific information through the respective supervisory authorities or other grants of legal authority; however, the EU regime is different in that it allows EIOPA to request information directly from (re)insurance undertakings in certain instances.

***Discussion:***

- ***The EU Approach:***

The Regulation that established EIOPA[4] applies the same professional secrecy obligations to EIOPA and its employees that apply to the supervisory authorities in EU Member States but does not include the same gateways for disclosure that are available for national supervisory authorities. EIOPA management and staff, as well as consultants engaged by EIOPA, are subject to EU laws concerning professional secrecy. EIOPA's internal professional secrecy rules define confidential material as including any information obtained from a national supervisory authority that is considered confidential under the laws of the providing jurisdiction. EIOPA has access to firm specific information through a number of avenues, including EIOPA's engagement in supervisory colleges, risk identification, crisis management and stress testing. Accordingly, EIOPA is required to observe absolute confidentiality with respect to such information, and confidential information may be used only for the purposes of carrying out EIOPA's duties as stated in EIOPA's founding regulation ("EIOPA Regulation"). Specifics regarding the future nature of regulatory reporting under Solvency II and the extent of EIOPA's access in this respect will be under discussion in the near future.

[4] In the case of EIOPA the Solvency II provisions also need to be seen in conjunction with Regulation no. 1094/2010 which mandates the Authority to undertake the following: develop draft regulatory technical standards ; develop draft implementing technical standards ; issue guidelines and recommendations; issue recommendations ; take individual decisions addressed to competent authorities; in cases concerning directly applicable Union law, take individual decisions addressed to financial institutions; issue opinions to the European Parliament, the Council, or the Commission; collect the necessary information concerning financial institutions [etc.]

EIOPA provides aggregated information on the EU insurance market to the European Systemic Risk Board (ESRB) to assist it in achieving its key task of preventing or mitigating systemic risks, and avoiding episodes of widespread financial distress. The ESRB[5] can make a reasoned request to EIOPA for data that is not in summary or aggregate form where it appears necessary for achieving the Board's tasks, but has not exercised this option to date. EIOPA is required to cooperate with the ESRB in having in place adequate internal procedures for the transmission of confidential information, in particular information regarding individual financial institutions. There is no gateway that would allow national supervisory authorities or EIOPA to share firm specific confidential information with the EU institutions (European Commission; European Council; European Parliament). Any information provided on the insurers' activity in the market would need to be in summary or aggregate form so that individual firm's activities cannot be identified.

- ***The Approach in the State-based Regime in the U.S.:***

In the U.S., the states – rather than the federal government – have primary regulatory responsibility for regulating the business of insurance, including for laws related to professional secrecy. The Dodd-Frank Act established the Federal Reserve Board of Governors (FRB) as the primary consolidated regulator for savings and loan holding companies, many of which are firms engaged in the business of insurance. The FRB has entered into memoranda of understanding with state insurance regulators regarding insurance entities. Federal government knowledge and involvement in insurance matters is enhanced by the establishment of the FIO, which has authority to monitor all aspects of the insurance industry and coordinate and develop U.S. Federal policy on prudential aspects of international insurance matters.

While there is no federal body mandating uniformity, state insurance regulators in the U.S. operate collectively to establish uniform standards in a variety of areas, including professional secrecy (see report of TC6).

State laws authorize the filing of certain information with the NAIC and declare that certain categories of information disclosed to the NAIC will be considered confidential in the possession of the NAIC. Although states are authorized to share confidential information with the NAIC in certain circumstances, the NAIC does not supersede the regulatory authority of the state insurance departments. Accordingly, the NAIC may not independently disclose confidential information provided to it by state insurance departments to other supervisory authorities, but the NAIC may facilitate such information exchanges among regulators as permitted under relevant law. Because the NAIC is not a department or agency of state or federal government, the NAIC does not fall within the types of government entities to which freedom of information laws may apply.[6] The NAIC occasionally enters into specific

[5] Art. 36 in EIOPA Regulation no.1094/2010 read in conjunction with Art. 15 in ESRB Regulation no.1092/2010

[6] The Missouri Court of Appeals affirmed the NAIC's exemption from Missouri's freedom of information law in *SNL Securities, L.C. v. National Association of Insurance Commissioners*, 23 S.W.3d 734 (2000).

information sharing and confidentiality agreements with individual states. The scope of the agreement may vary depending on the subject matter of the project for which an agreement is required, the confidential information to be provided to the NAIC, and the manner in which such information is to be used and/or stored by the NAIC. The NAIC maintains confidentiality policies to protect confidential information from disclosure. As a condition of employment, all NAIC employees agree to be bound by such policies during – and following – their term of employment.

NAIC model laws and the financial regulatory accreditation program provide means for establishing standards against which state regulators hold each other accountable. Several NAIC model laws provide a legal template for enhancing confidentiality protections as well as authorizing the commissioner to disclose and receive confidential information with other regulators, including international regulators. Exemplary model laws include the Model Law on Examinations, the Risk-Based Capital Model Act, the Insurance Regulatory Information System Model Act, the Insurance Holding Company System Regulatory Act, and the Producer Licensing Model Act. As illustrated below, many of these model laws provide key legal elements associated with the NAIC accreditation program. It is important to note, however, that states have not necessarily amended their insurance statutes exactly as the model laws may propose. For example, many state confidentiality statutes pre-date the amendments to the NAIC model laws. States may have determined their existing statutes sufficiently provided for the confidentiality and information sharing intended to be authorized by the model laws and as required for purposes of the NAIC accreditation program.

The NAIC Financial Regulation Standards and Accreditation Program (see report of TC6), in part, requires states to have certain statutes in place that evidence the legal authority to regulate for financial solvency. In order to achieve accreditation, states must have specific laws related to information sharing. Accreditation standards and guidelines require the insurance department to demonstrate it has the authority to share confidential information with state, federal and international regulators; that the department has the authority to keep confidential information obtained those same regulators from disclosure; and that the department has a written policy concerning information exchanges with other regulators. Additionally, states also must demonstrate they have statutes related to information sharing on the specific topics of examination authority, risk-based capital and holding company systems.

**Topic 4**: Regulatory gateways for exchange of information

***Key Commonalities:***

- Both regimes include general authorizations to share confidential information with other financial regulators, law enforcement officials and other governmental bodies in need of such information to perform their duties. Confidential information may only be disclosed to such persons if they can maintain confidentiality and/or demonstrate

their ability to protect such information from disclosure when the information is in their possession.

- Both regimes acknowledge the possibility of utilizing and disclosing information in receivership and bankruptcy actions, prosecuting regulatory and criminal actions, and pursuant to certain court actions.

***Key Differences*:**

- As stated before, the main difference lies in the differing structural approaches of the two regimes as to ways of establishing these gateways. EU law sets out the overall common approach while in the case of the state-based regime in the U.S., individual state laws provide the gateways for sharing of information and can vary.

***Discussion:***

- ***The Approach in the State-based Regime in the U.S.:***

In the U.S., the circumstances under which confidential information may be shared – either generally or for limited purposes – will depend on state law authorizations and be governed by any applicable agreements. State laws are generally consistent with NAIC model laws in substance. Accordingly, state laws related to sharing confidential information typically provide for the following:

- That certain information shall be deemed confidential and privileged by law;
- That the information shall not be subject to state freedom of information or open records laws;
- That the information shall not be subject to subpoena and shall not be subject to discovery or admissible in evidence in a private civil action;
- That the commissioner or other regulatory officials shall not be permitted to testify in a private civil action concerning such information;
- That the information may be used in furtherance of the commissioner's official regulatory duties;
- That the commissioner may share the information with other state, federal and international regulators and law enforcement agencies, as well as the NAIC, provided the recipient agrees to maintain the confidentiality of the information and possesses the authority to do so;
- That the commissioner may receive such information from other state, federal and international regulators and law enforcement agencies, as well as the NAIC, and shall maintain the confidentiality of the information, provided it is received with the understanding that it is confidential under the laws of the providing jurisdiction; and
- That the commissioner is authorized to enter into agreements governing the sharing and use of confidential information.

This framework protects confidential information from disclosure through public records requests as well as through subpoenas and other discovery methods in private court cases. State insurance regulators, however, are generally permitted to share confidential information with other state, federal and international insurance and financial regulators and law enforcement agencies as well as the NAIC. The result is that state regulators possess broad authority to share confidential information with regulatory counterparts that require such information in course of their official duties provided the information can be maintained as confidential in their possession. To that end, state insurance regulators have entered into a Master Information Sharing and Confidentiality Agreement that details the methods of information exchanges and information protection among state regulators. Also, state insurance regulators have entered into information sharing and confidentiality agreements with federal regulatory bodies, including the Federal Reserve, Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (FDIC). As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), it is possible that state insurance regulators will enter similar arrangements with the FIO and the Financial Stability Oversight Council as those bodies carry out their respective responsibilities to monitor the insurance industry and oversee financial system stability. Further, several states have entered into MoUs authorizing information exchanges with international counterparts.

State laws also permit limited-purpose sharing of confidential information in specific situations where outside expertise assists the regulator in furthering regulatory objectives. For example, state laws based on the NAIC Model Law on Examinations authorize the commissioner to retain experts and consultants and state laws based on the NAIC model Insurance Holding Company System Regulatory Act (IHC Model Act) similarly authorize the commissioner to retain outside experts to assist with studying proposed acquisitions and examinations. These engagements require third-party consultants to agree to maintain the confidentiality of any information shared by the regulator.

State insurance regulators are generally permitted to utilize confidential information in administrative and judicial proceedings, though they may be restricted in doing so pursuant to the terms of the information sharing agreements. State confidentiality laws generally include a reservation that allows the commissioner to use confidential information in furtherance of regulatory or other enforcement actions. Therefore, confidentiality does not become a barrier to the commissioner enforcing the laws of the state relative to an insurer. Similarly, state receivership laws provide for sharing information with the court charged by statute with overseeing the administration or liquidation of an insurer and for the confidentiality of information that may be disclosed to the court. Additionally, courts utilize protective orders and *in camera* disclosure as additional means of protecting confidential information.

- ***The EU Approach:***

Solvency II, and the currently applicable EU directives, provide for a similar information sharing framework in the EU. Solvency II permits and promotes the exchange of information among insurance supervisory authorities in EU Member States. EU supervisors that receive

confidential information from another EU supervisor may only use such information in the course of their official duties and for purposes such as monitoring a (re)insurance undertaking, imposing sanctions or administrative appeals. EU supervisors may also share information with other supervisors in the same Member State in the discharge of supervisory functions. At directive level a closed list of bodies/authorities/institutions other than insurance supervisors are identified as permitted recipients of supervisory information. These bodies/authorities/institutions in the same Member State and other Member States with which such information may be shared include banking and financial supervisors, bodies involved in bankruptcy or liquidation matters, and auditors.

Member States are authorized to enter into cooperation agreements providing for information sharing with regulatory and supervisory authorities in non-EU countries under certain conditions. The primary conditions for sharing of confidential information are that the information be subject to guarantees of professional secrecy at least equivalent to those included in Solvency II and that the information be used in the performance of supervisory duties in those countries. If such conditions are fulfilled, then confidential information may be disclosed to bodies involved in bankruptcy and liquidation matters, authorities responsible for overseeing statutory audits of financial institutions (including regulators of insurance undertakings) and independent actuaries in third countries which are carrying out legal supervision. Accordingly, this provision provides a gateway for EU supervisors to exchange information with state insurance regulators. This provision does not permit direct information exchanges with the NAIC, but such exchanges are not foreseen presently.

Solvency II and existing directives address information exchanges related to financial stability and law enforcement. In order to protect the stability and integrity of the financial system, Solvency II authorizes information exchanges between supervisory authorities and those authorities responsible for the detection and investigation of breaches of company law. Further, confidential information may be disclosed to other governmental departments responsible for legislation on credit institutions, financial institutions, investment services and insurance undertakings as well as inspectors operating on behalf of such entities. In the above cases, information originally obtained from another supervisor may be shared only where express consent has been granted. Finally, supervisory authorities may share confidential information with central banks and similar bodies as well as public authorities responsible for overseeing payment systems.

In limited circumstances, European supervisory authorities may disclose confidential information to courts and administrative panels. Such disclosures are restricted to appeals against refusal of authorization or licensure, home state supervisor refusals to pass along information related to the establishment of a branch or the provision of services in another Member State, and appeals against adverse decisions by the supervisory authority.

**Topic 5:** Methods for exchanging information across borders

***Key Commonalities:***

- Both regimes allow for regulators to enter into agreements or MoUs with counterparts in other jurisdictions to facilitate the sharing of confidential information. With regard to the use and need for co-operation agreements both regimes require or otherwise ensure such arrangements are in place in order for supervisors to be in a position to share confidential information with other supervisory authorities. In both regimes, supervisors are fully empowered to engage in exchange of information across border.

- Both regimes provide broad discretion to regulators to establish the terms of such agreements, including the verification of each regulator's ability to maintain the confidentiality of information received from another jurisdiction.

- In both regimes supervisors may add to the legal/statutory restrictions additional provisions any other safeguards/relevant provisions to ensure legal requirements enabling information transfer are satisfied.

***Key Differences:***

- Differences occur as to methodology and process to be followed. Both regimes address the issue of potential sharing of information with third parties, but achieve similar outcomes in different ways. EU Member State requirements that the recipient of confidential information obtain explicit permission from the originating source before sharing with another regulator are often developed as a result of legal constraints under the EU directives, while state insurance regulators in the U.S. are bound by general legal requirements to respect the confidentiality of information under the laws of the providing jurisdiction and the memorialization of this respect in written confidentiality agreements.

***Discussion***:

- ***Comparative Description:***

As detailed in previous sections, while within the EU the Solvency II Directive specifically allows for direct exchange of information with other competent authorities for insurance supervision (i.e. no specific arrangements need to be made/instruments to be signed) in the state-based regime in the U.S., the rules and procedures to be observed for the purpose of information sharing and exchange among state supervisors are set in the Master Information Sharing and Confidentiality Agreement. The Master Agreement satisfies requirements in state laws that the receiving party of confidential information agree in writing to keep information confidential and demonstrate that they possess the statutory authority to maintain the confidentiality of such information.

For the EU Member States, Solvency II directly provides them with the legal ability to engage in cooperation agreements providing for the exchange of information with the supervisory authorities of third countries or with a closed list of authorities or bodies of third countries[7]. In the state-based regime in the U.S., there appears to be no material differences between the methodology for sharing information among state supervisors and that used for sharing information with foreign supervisors. That is, state insurance supervisors in the U.S. utilize MoUs to provide the framework and establish expectations with respect to information exchanges where they are authorized by law to share confidential information.

In both regimes, the exchange of confidential information is subject to requesting authority fulfilling a clear set of professional secrecy requirements. State insurance supervisors in the U.S. typically include in the body of the MoU the conditions that apply to the information received/passed on to a foreign supervisor which may include *inter alia*:

- Limitations on use of confidential information;
- Protections to be set in place to safeguard confidential information from disclosure and preserve any privileges;
- Rules for ways information sent/received may be forwarded to another authority/body.

For the EU supervisors, the signing of the cooperation agreement is conditional to two main elements:

- The third country provides guarantees of professional secrecy at least equivalent to those of Solvency II[8] ;
- The information exchanged must be intended for the performance of the supervisory task of those authorities or bodies.

From the EU perspective, cooperation agreements[9] are normally not legally binding nor enforceable in law. They are statements of intent and if there is a breach of the provisions the agreement may be terminated. Nevertheless, cooperation agreements may include the conditions of professional secrecy under which EU Authority accepts to pass on the information to the third country supervisor.

With regard to expectations regarding onward disclosure by recipient authorities, the practical operation of both the EU and the state-based framework in the U.S. provide that the same outcome is achieved, i.e. the authority in which the information originates provides its express agreement for the forwarding to another authority/body.

[7] As defined in Art. 68 (1) and (2) i.e. bodies involved in bankruptcy and liquidation matters, authorities responsible for overseeing statutory audits of financial institutions (including regulators of insurance undertakings) and independent actuaries in third countries which are carrying out legal supervision

[8] As set in Art. 64 i.e. all persons who are working or who have worked for the supervisory authorities, as well as auditors and experts acting on behalf of those authorities, are bound by the obligation of professional secrecy meaning that any confidential information received by such persons whilst performing their duties shall not be divulged to any person or authority whatsoever, except in clearly stated circumstances.

[9] usually taking the form of Memoranda of Understanding

In the EU approach[10], even in the presence of an equivalent set of guarantees of professional secrecy, the information received by a Member State from another Member State authority cannot not be disclosed onwards to a third country supervisor without the express agreement of the Member State authority where the information originated and where appropriate, solely for the purposes for which Member State authority where the information originated gave its agreement. Under the state-based approach[11] in the U.S., the requesting authority is required to acknowledge that all confidential information, in whatever form, furnished by the responding authority remains the property of the responding authority and agrees to take no action the effect of which would be to limit, waive or jeopardize any privilege or claim of confidentiality, including the disclosure of confidential information, without the express written permission of the responding authority.

**Topic 6**: Confidentiality of non-public supervisory information received by the FIO

In furtherance of its duties under Federal law, the FIO could be a recipient of non-public supervisory information regarding a third country (re)insurance undertaking that pursues business in the United States via a U.S. subsidiary. For example, as a non-voting member of the Financial Stability Oversight Council (FSOC) established by the Dodd-Frank Act, the FIO could receive such non-public supervisory information. In addition, the Dodd-Frank Act expressly authorizes the FIO to enter into information-sharing agreements and to analyze and disseminate data and information.

The Dodd-Frank Act requires the FSOC, the FIO, and the Office of Financial Research (OFR), which is an office within the U.S. Department of the Treasury that was also established by the Dodd-Frank Act, to maintain the confidentiality of any data, information, and reports submitted under that Federal law. All FSOC members entered into a MoU that sets out the understanding of all FSOC members regarding the treatment of non-public information. The MoU presumes that non-public information exchanged under its terms is confidential.

There are, however, limitations. For example, information or data submitted to Federal agencies (which includes the U.S. Department of the Treasury, of which the FIO is a part) is generally subject to the provisions of the Federal freedom of information law. That Federal law, called the Freedom of Information Act (FOIA), includes exceptions to its public release requirements. In addition, the Dodd-Frank Act expressly states that the FOIA, and the exceptions under it, apply to the FIO.

The "Standards of Ethical Conduct for Employees of the Executive Branch" (Standards) and the "Department of the Treasury Employee Rules of Conduct" contain restrictions on the disclosure and use of non-public information by Treasury employees (which includes FIO

[10] Art. 66 par. 2 – Solvency II Directive
[11] As per Master Information Sharing and Confidentiality Agreement

employees). The Standards provide that an employee shall not allow the improper use of "nonpublic information" to further his or her own private interest or that of another, whether through advice or recommendation or by knowing unauthorized disclosure. In addition, employees are prohibited from disclosing official information without authority. Failure to adhere to these standards can subject employees to serious sanctions, including removal from office. Further, a Federal criminal law called the Trade Secrets Act (TSA) prohibits officers and employees of Federal agencies (which include FIO employees) from publishing or disclosing trade secrets and other confidential business information to any extent not authorized by law. The TSA applies to public disclosures and not intra-governmental disclosures of information. A violation of the TSA carries with it the risk of removal from Federal employment, fines, and imprisonment of up to one year. Moreover, as an office within the U.S. Department of the Treasury's Departmental Offices (DO), the FIO's information technology systems are run on DO platforms that are protected at a HIGH level of sensitivity under the National Institute of Standards and Technology (NIST) Federal information processing standards. The protections afforded such systems are available on the NIST website at csrc.nist.gov.

## 2. Group Supervision

### Introduction

In general terms, a "group" refers to more than one company that coexists as part of a corporate family by virtue of ownership or affiliation. Generally speaking, an insurance group is comprised of two or more insurers, but there could be other legal entities involved as well – holding companies; subsidiaries or affiliates such as agencies, service providers or third party administrators whose business is tangential to that of the member insurers; and other entities whose business is unrelated to the insurance operations of the group.

Again in general terms, group supervision is the application of regulatory oversight to a group. Group supervision has become an important aspect of the overall supervisory process because group membership can pose unique risks (e.g. reputational risk) as well as benefits (e.g. capital options, risk diversification) to one or more insurance undertakings that are members of the group. Group supervision therefore is an important complement to solo supervision in ensuring policyholder protection.

In this TC2 report the state-based insurance regulatory regime in the U.S. and the Solvency II regime in the EU are compared as to their respective requirements and processes for group supervision. Group supervision is an important complement to solo supervision in ensuring policyholder protection. For certain U.S. insurance groups, with a bank or thrift, consolidated supervision is conducted by the Federal Reserve Board with an emphasis on protecting the depository institution. In the EU, financial conglomerates are regulated under the Financial Conglomerates Directive (FICOD).

### Executive Summary:

- Policy Objectives: The over-arching objectives are essentially the same i.e., to protect policyholders and to enhance financial stability. That said, there are various differences between the EU and state-based U.S. regimes in the manner in which those objectives are achieved with respect to group supervision.

- Scope of Group Supervision: In both regimes, various legal entities within the group can be included in the scope of group supervision. The scope of group supervision in the EU according to the Solvency II Directive is the entire group, i.e., all entities within the group, regulated or otherwise, on a global basis. However, the group supervisor has authority to narrow that scope subject to prescribed criteria. In the U.S., traditional application of group supervision has focused on the holding company and its insurance subsidiaries in the U.S.

- Supervisory Colleges: Both regimes are generally similar in terms of the operations of supervisory colleges; however the role, tasks, powers and content of the group-wide supervisor differ between the two regimes. Moreover, the EU's Solvency II regime provides for a legally binding regime, whereas the U.S. operates a less formal, non-binding one. Nonetheless, both approaches are intended to drive joint/collaborative decisions as to any supervisory actions in the EU at the solo and group level and in the U.S. at solo level as well as actions aiming to achieve outcomes at the group level.

- Supervisory Powers at the group level: Under Solvency II in the EU, there is a single group supervisor with explicit duties and powers that are applicable to legal entities and as well as to insurance holding companies which are located in the European Economic Area (EEA). Group supervisors in the EU can request insurance holding companies in the EU to hold more capital to cover excessive risk in other jurisdictions. However, in the case of an insurance holding company located in a Member State other than that of the group supervisor, the group supervisor needs to inform the competent supervisor or jurisdiction where the holding company is located with the aim to have that supervisor take the necessary action. The U.S. state-based regime focuses on the application of powers at the legal entity level and with regard to insurance holding company systems on information gathering and examination. Insurance regulators have limited extra-territorial powers and rely on communications and cooperation with other regulators in other jurisdictions who have the authority to take necessary actions.

- Reporting at the group level: In the EU, reporting is standardized and required for all groups on a consolidated basis. Groups have to make similar submissions to that of solo undertakings (Solvency and Financial Condition Report (SFCR), Regular Supervisory Report, Quantitative Reporting Templates (QRTs), Own Risk and Solvency Assessment (ORSA)) but with additional information and data which are group-specific. In the state-based regime in the U.S., reporting at the group level is focused on extensive intra-group reporting requirements to support required prior-approval processes based on legal standards and financial analysis; consolidated financial information is used in the U.S. where available, i.e., for listed companies, those that otherwise voluntarily provide such information, and where state insurance regulators otherwise require it through filing, analysis or examination processes.

- Group Capital: The EU has an explicit group capital requirement, whereas the state-based regime in the U.S. does not.

- Group ORSA: Both regimes have an ORSA requirement that is similar in concept, but the EU sets in law the process and key components of the assessment and has guidelines that are more prescriptive, whereas in the U.S., more management discretion is allowed as to the use of methodologies, with disclosure and justification.

- Group Governance: In both regimes, companies have to comply with corporate governance requirements as set forth in federal and state laws. Publicly-listed companies also must abide by rules set by the various stock exchanges. U.S. insurers are subject to state corporate laws, in addition to various governance requirements embedded in state insurance laws and regulations. In addition to corporate governance requirements, EU Solvency II internal governance requirements also exist, e.g., with respect to internal controls and risk management systems as well as key functions. In the U.S., supervisors assess those aspects during on-site examinations for the purpose of designing examination procedures.

- Regulation of Financial Conglomerates: For those insurance groups which are Bank Holding Companies (BHCs) or Savings & Loan Holding Companies (SLHCs), the Federal Reserve has explicit capital requirements. In the EU requirements for conglomerates are set in FICOD.

## Topic 1: Policy Objectives

### *Key Commonalities*

Both regimes set as a primary policy objective for group supervision the protection of the policyholders (of insurers); group supervision is an important part of achieving that goal. In neither regime are insurance regulators or supervisors charged to protect shareholders and other creditors of the entire group from their investment, credit or other risks. However, the two regimes pursue this shared objective in different fashions. Another shared objective of group supervision is to enhance the financial stability of the insurance group. While there are aspects of group supervision that differ between the two regimes as described in subsequent sections of this report, group supervision – as defined in each respective jurisdiction – exists in parallel with solo supervision.

### *Key Differences*

The approach of the state-based regime in the U.S. to group supervision, as embodied in the NAIC Insurance Holding Company System Model Act and accompanying regulation (IHC Model Act) has been described as a "windows and walls" approach, whereby regulators have "windows" to identify relevant group business activity and assess its potential impact on the ability of the insurer to pay its insurance contract obligations and "walls" to protect the capital and assets of the insurer by requiring insurance commissioner prior approval of material related party transactions. Although state insurance regulators do not directly license and regulate the holding company, the objective of the windows and walls approach is to ensure that a holding company benefits from the profits of the insurance company only to the extent the domiciliary regulator determines that material distributions to the holding company will not weaken the financial position of the insurer and provides contemporaneous advance approval of such "extraordinary dividends."

Under the Solvency II regime, insurance group supervision means supervision of the insurance group viewed as an economic entity in and of itself (in contrast to the sum of the supervision of the individual entities within the group).

## Topic 2: Concept and Scope of Group Supervision

***Key Commonalities***

Both regimes strive for including the group perspective into insurance supervision and to evaluate intra-group transactions (IGTs), non-insurance business risks and related activity, however, the concept and the scope of group supervision differs between the two.

### 2.1. Concept of Group Supervision

***Key Differences***

In the EU, the Solvency II regime is a legal system that provides for a risk-based, economic-based, and principle-based framework for the supervision of (re)insurance undertakings, as well as groups. Under the Solvency II regime, insurance group supervision refers to the prudential supervision exercised by a group supervisor in coordination with local supervisory authorities on an insurance group, including all entities of the group, also non-insurance undertakings, viewed as an economic entity in and of itself.

In the state-based regime in the U.S., recently adopted NAIC amendments to the NAIC's IHC Model Act: (1) extend the state insurance regulator's authority to access information regarding any entity within the insurance holding company system that could pose enterprise risk to the insurer; (2) provides state insurance regulators with enhanced information about corporate governance; (3) provides reporting by the insurer on material risks within the insurance holding company system that could pose enterprise risk to the insurer and examination authority on a top-down basis with respect to enterprise-wide risks; and (4) provides for participation in supervisory colleges[12]. If state insurance regulators determine enterprise risk to the insurer they can exercise examination authority over any entity within the group that poses that enterprise risk. In the EU, supervisory authorities have legal power to directly exercise authority over an affiliate or the ultimate parent undertaking.

It is not the aim of state insurance regulators in the U.S. to supervise non-insurers, but to have information about them and when needed to be able to examine them for purposes of understanding risk to the insurer(s) in the group. Further, state insurance regulators use such findings in tailoring supervisory plans for insurers and/or insurance groups.

[12] NAIC Model 440 (HC Act) Section 7 provides for participation in supervisory colleges.

In the EU, the definition of the group according to Art. 212 of the Solvency II Directive includes any kind of related undertaking, even non-regulated and non-financial, although the scope of group supervision may be applied more narrowly – see Section 2.2.

## 2.2. Scope of Group Supervision

***Key Differences***

In the EU, the global principle applies under which all undertakings within a group are covered by group supervision (see Art. 213(2)(a-d)). The scope of group supervision therefore includes undertakings in third countries, although the group supervisor's powers vary depending on whether the holding company is located within or outside of the EU – see Section 5.2.

The EU regulation, however, allows for an exclusion of entities from group supervision. The decision on this issue is taken by the group supervisor after consulting with the college of supervisors and is based on the criteria of Art. 214 (2). Where those criteria are met, the group supervisor may decide on a case-by-case basis to exclude an undertaking from the group supervision.

The state-based regime in the U.S. employs the lead state concept, which could include more than one lead state, but encompasses all U.S. domiciled (re)insurers within a group. The risk-focused examination approach (see TC7) has added requirements that examiners consider group risk to the insurer, consistent with the "windows and walls" approach taken generally in the state-based regime. Additional consideration is given by examiners during the examination process to information about the group as a whole, its composition and structure, the degree to which capital could be allocated across the group and to provide additional support to the insurer if needed, restraints on the movement of capital, etc. Once the changes to the NAIC IHC Model Act have been enacted, state insurance regulators will have access to the insurer's affiliates as reasonably necessary to ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis or to determine compliance with the holding company act.

In the state-based regime in the U.S., the IHC Model Act applies to any Insurance Holding Company System which is defined as an affiliation of two or more persons, any one of which is an insurer. A "person" is defined as an individual, a corporation, a limited liability company, a partnership, an association, a joint stock company, a trust, an unincorporated organization, any similar entity or any combination of the foregoing acting in concert, but shall not include any joint venture partnership exclusively engaged in owning, managing, leasing or developing real or tangible personal property.

## Topic 3: Key Elements of Group Supervision

### 3.1 Group Capital Requirements

***Key Commonalities***

The TC3 report covers capital calculation methodologies and requirements at the solo level for both regimes. Only to the extent that there are additional or different capital requirements at the group level are such key aspects covered in this section of the TC2 report.

Both in Solvency II at the group as well as at the solo level and in the state-based U.S. regime at the solo level, capital requirements are supported by the requirements on fit & proper, supervisory review, reporting to supervisors, and market discipline through public disclosure. Both use capital measures in combination with other tools that can also trigger regulatory action.

The primary regulatory objective of both regimes is to protect policyholders. To achieve this objective, both regimes have capital requirements that provide thresholds for corrective and regulatory action, but they are determined differently.

***Key Differences***

The Risk Based Capital (RBC) formula used in the state-based regime in the U.S. is factor-based, generated from historical industry-wide data experience, with some use of internal models regarding interest rate and market risk. The NAIC's RBC formula derives a RBC ratio where the parent company is an insurance company; otherwise, and when necessary, U.S. regulators follow an aggregation method for assessing overall insurance group capital. However, unlike the Solvency II Directive, the state-based regime in the U.S. does not provide for an explicit group capital requirement. Nevertheless, U.S. supervisors will have insights into an insurance holding company's own assessment of their group capital needs and will gain a better understanding of their group's overall capital adequacy from management's perspective via the ORSA – see section 3.6.

In the EU regime, there is an explicit Group Solvency Capital Requirement (Group SCR). The key aspects of the EU's group solvency assessment include a "total balance sheet approach"; use of the accounting consolidation method as the default approach calibration to a confidence level of 99.5% over a one-year period; use of a standard model with the option for a group to use an internal model with approval of the group supervisor; group SCR covers all quantifiable risks relating to existing business and also to new business expected to be written in the 12 following months (e.g., for liability and other long-tail business, including a projection of future cash flows); and a risk diversification benefit, which may be limited due to constraints on the assessment of risks on a consolidated basis, limited access to information or lack of fungibility or transferability of capital within the group. Although the accounting

consolidation method is the default approach, the group supervisor may allow the deduction and aggregation method or a combination of both methods, subject to certain criteria.

In the state-based regime in the U.S., risk aggregation is carried out in two ways: The first is through RBC, to the extent there is ownership of a downstream insurer by another insurer. Risk aggregation in that situation is handled in the content of RBC. The NAIC RBC does not address aggregation across insurer affiliates. Also, in a group ORSA, the group is expected to address aggregation, but there is not a prescribed manner in which to do so.

Diversification is considered in RBC through the covariance adjustment, and there would be some impact as well across entities in the case of a downstream insurance subsidiary – but not across other insurance or non-insurance affiliates. Also, in a group ORSA, the group is expected to address diversification in a manner as determined appropriate by the insurance group's executive management.

State insurance regulators have access to and monitor consolidated financial statements for publicly listed companies and certain other groups. With recent changes to the IHC Model Act, state insurance regulators will also have access to Enterprise Risk Reports submitted by the insurers that will provide information as to any developments on the assessment of risk across the group that may impact on an insurer.

In the EU, participations in undertakings outside the financial sector (over which the group has a dominant influence and in which it has significant interests) should be consolidated using the equity method. In this context, the relevant capital invested is calculated on the basis of the value of the participation (using variables such as the equity risk charge and the concentration risk charge). The treatment of the Group SCR then equates to that of the individual SCR.

If the participation in an insurance or reinsurance undertaking amounts to a significant influence (>20%), its share of the Group SCR will be calculated as the equity stake multiplied by the individual SCR for this participation. The contribution of insurance undertakings and Special Purpose Vehicles (SPV) over which the group has a significant influence constitutes the non-controlled participation SCR. Without taking diversification effects into account, this is added to the SCR for consolidated insurance and reinsurance entities. In the U.S., if the participation in an insurance or reinsurance undertaking creates control (presumed to exist at >10% or also through contract or otherwise), the equity method of accounting is applied and the RBC formula applies a risk factor to the resulting investment balance.

Under Solvency II, in specific circumstances where the risk profile of the group is not adequately reflected, a capital add-on to the Group SCR may be imposed under Art. 232a. Under the state-based insurance regulatory regime in the U.S., there is no explicit group capital requirement and, by extension, no explicit capital add-on requirement either[13];

[13] For BHCs and SLHCs in the U.S. under the supervision of the Federal Reserve reference is made to the last section of this TC2 report.

however, where financial analysis indicates potential risk to insurance undertaking(s) in a group due to capital issues or concerns at the group level, state insurance regulators are authorized to take action with regard to the undertaking so as to protect its policyholders by strengthening the walls between the undertaking and the group risk, and/or by applying such pressure on the undertaking as is necessary so as to cause the holding company to submit and comply with a capital remediation plan that is acceptable to the regulator.

In the EU, in case of a financial conglomerate the group capital requirements will be calculated for each part (e.g., banking or insurance part within the group) separately according to their sector-specific requirements.

### 3.2. Group Own Funds (available capital)

***Key Commonalities***

In the case of a financial conglomerate the recognition of diversification effects between two different sectors at the group level (insurance sector and banking sector) is legally prohibited in the EU Solvency II approach as well as in the U.S. approach. The group own funds/available capital will be calculated according to their sector-specific requirements.

In both regimes, there are limits and regulatory oversight that are intended to assure that the capital of an insurance undertaking is not diminished inappropriately through activities of the group, e.g., via extraordinary dividends or through intercompany transactions on terms that are not fair and reasonable.

***Key Differences***

State insurance regulators in the U.S. require the filing of statutory-basis financial statements by solo insurers, but generally require consolidated filings by groups on an as-needed basis. The Solvency II approach for the own funds adopts a tiering system (Tier 1, Tier 2 and Tiers 3) and allows for aggregation at the group level. In order to be regarded as eligible own funds at group level, they must be fungible and transferable without any legal obstacles. Where the supervisor considers that certain own funds eligible for the SCR of a related insurance or reinsurance undertaking cannot effectively be made available to cover the Group SCR, those own funds may still be included in the Group SCR calculation but only in such amount that is eligible for covering the SCR of the related undertaking (Art. 222 of the EU Solvency II Directive).

### 3.3. Group Reporting and Disclosure

Reporting and disclosure are aspects of insurance supervision that are covered in more detail in TC5. However, matters that are specific to reporting by groups are covered below.

***Key Commonalities***

Both regimes have requirements for group reporting with a particular focus on group-specific risk and IGTs (see separate section 3.4 below as regards IGTs).

Both regimes disclose publicly some information. For example, in the U.S. there is public disclosure of significant IGTs. In the EU, there is public disclosure of the group balance sheet, Group SCR, group own funds, group risk concentration and qualitative information on relevant operations and transactions as well as governance arrangement that affect IGTs.

Both regimes will require an ORSA report, however, the expected scope and legal nature of its requirements is different.

***Key Differences***

In the EU regime, groups have to make similar submissions to that of solo undertakings (SFCR, Regular Supervisory Report, QRTs, ORSA) but with additional information and data which are group-specific. In the state-based regime in the U.S., there is submission of specific insurance holding company filings which is distinct from the individual requirements; this includes financial information of the ultimate controlling person, and information to enable an assessment of fit and proper requirements, with rights of inspection (i.e., examination).

There are differences in the level and details of information reported. Financial statements and exhibits that comprise the annual statement filing to state insurance regulators in the U.S. are prepared on a solo basis. However, the IHC Model Act, which has been adopted in all states, provides authority for the state regulator to require or request financial statements of all entities within the insurance holding company system. The act specifically mentions that the requirement can be met by submitting audited financial statements as filed with the U.S. Securities and Exchange Commission (SEC). Approximately 60% of the U.S. premium is written by groups that are public companies and which therefore file consolidated financial statements with the SEC. Non-listed groups that prepare consolidated financial statements in the ordinary course of business also would submit consolidated filings to meet the requirement. All other groups must submit stand-alone financial statements of all entities within the group.

In the EU regime the required reports apart from the prudential information contain additional and more specific information regarding: the group’s business and performance; the group's system of governance (for example information on material specific risks at group level); and the group’s capital management (for example, qualitative and quantitative information on the SCR and own funds, or a description of special purpose vehicles, or SPVs, within the group).

In the EU Solvency II regime, the groups are required to disclose publicly a report on the solvency and financial condition (including a description of the legal structure, governance and organizational structure of the group) at the level of the group. There also are other requirements on the type of information that has to be publicly disclosed. In the state-based regime in the U.S., an Enterprise Risk Report will apply to certain large insurers and/or insurance groups. As compared to the ORSA Report in the U.S., the Enterprise Risk Report is more prescriptive and qualitative, asking for factual information about changes or developments of significance, particularly those with negative implications. A schedule in the Annual Statement also publicly discloses the nature and amounts of transactions between a U.S. insurer and any of its affiliates, as well as an organization chart of the entire group.

### 3.4. Intra-Group Transactions

***Key Commonalities***

Detailed statutory requirements for reporting certain IGTs (e.g., dividends, cost-sharing contracts, reinsurance agreements, etc.) are prescribed in the EU and in the state-based regime in the U.S. The EU Solvency II regime calculates in the standard formula the credit and default risk of entities. The U.S. RBC approach considers the credit and default risk as well; credit risk is addressed through the aggregation and diversification assumptions and methodologies that will be incorporated into a group's ORSA. In the EU Solvency II regime when the group supervisor assesses the appropriateness of the use of the deduction and aggregation method, the group supervisor should consider the presence of IGTs between the entities that will be using the deduction and aggregation method.

***Key Differences***

The thresholds and frequencies for reporting IGTs vary between the two regimes.

In the state-based regime in the U.S., the IHC Model Act contains a list of transactions, with various thresholds, that need to be prior-approved by the domestic insurance commissioner (e.g., sales, purchases, exchanges, loans, extensions of credit, or investments, and any other transaction that may be material as defined in the Act). The group annual filing includes a statement that transactions entered into since the filing of the prior year's annual registration statement are not part of a plan or series of like transactions, the purpose of which is to avoid statutory threshold amounts and the review that might otherwise occur. Annual filings include an organization chart of the group and amounts for intercompany transactions.

The EU supervision of IGTs requires all significant IGTs by insurance and reinsurance undertakings within a group, including those performed with a natural person with close links to an undertaking in the group to be reported after-the-fact on a regular basis and at least annually to the group supervisor. The group supervisor, after consulting the other supervisory

authorities concerned and the group, identifies the type of significant IGTs insurance undertakings in a particular group must report in all circumstances.

Regarding the assessment of the IGTs in the EU Solvency II regime, they are assessed primarily at the group level but also at the solo level. For the state-based regime in the U.S., generally, IGTs have traditionally been assessed from the perspective of the solo insurance entity. Going forward, and to the extent that they may have a material impact on the holding company, a group ORSA assessment pursuant to the state-based regime in the U.S. may address them as well; however, the manner in which that may occur is not prescribed.

### 3.5. Risk Concentrations

***Key Commonalities***

In both regimes risk concentrations at group level have to be considered and reported.

In both regimes supervisors may impose limitations on risk concentrations, however, in each regime the imposition of such limitations is handled differently at the solo and group levels. At the solo level in both regimes, there is required reporting of credit exposures, including reinsurance, and regulators/supervisors can impose limitations directly.

***Key Differences***

In the state-based regime in the U.S., risk concentrations are reported by solo insurers in audited financial statement disclosures[14] and by groups in disclosures in SEC filings[15].

The EU Solvency II regime requires insurance undertakings or insurance holding companies to report at least annually to the group supervisor any significant risk concentration at the level of the group. The group supervisor, after consulting the supervisors concerned and the group itself, may impose appropriate thresholds for the reporting of risk concentration based on solvency capital requirements, technical provisions, or both. Specific requirements are imposed on the group supervisor who, while reviewing the risk concentrations, particularly monitors the possible risk of contagion in the group, the risk of a conflict of interests, and the level or volume of risks.

In the state-based regime in the U.S., risk concentrations are reported at the solo level at least annually through various Annual Statement schedules, the RBC report, and other financial information included in the financial statements. Going forward, the ORSA (to be required of larger groups and (re)insurers) is expected to address concentration risk at group level in the context of the company's own capital adequacy assessment for the group. While the holding company in its Enterprise Risk Report is not mandated to report risk concentrations per se, it

[14] AICPA Statement of Position 94-6, Disclosure of Certain Significant Risks, and Uncertainties; FASB Statement No. 107, Disclosures About Fair Value of Financial Instruments.
[15] Notably, Form 10-K instructions relating to disclosure of Risk Factors.

does however require identification of material concerns of the insurance holding company system raised by the supervisory college, if any, in last year; and of any material activity or development of the insurance holding company system that, in the opinion of senior management, could adversely affect the insurance holding company system.

### 3.6. The Group ORSA (Own Risk and Solvency Assessment) and Enterprise Risk Management

***Key Commonalities***

In both regimes, the ORSA will be reported at least on an annual basis. Group ORSA in general refers to the processes and procedures used to identify, assess, monitor, manage, and report the short and long term risks a (re)insurance group faces or may face and to determine the group's capital adequacy ("prospective solvency assessment") from the company-own perspective.

***Key Differences***

While an ORSA will exist in both regimes, the primary difference is that the legal requirements are more prescriptive in the EU, whereas in the U.S., more discretion will be left to management to determine (and justify) the specific methodologies chosen.

In the state-based regime in the U.S., an ORSA Guidance Manual has been adopted that provides regulators' expectations for insurers to complete their ORSA. The ORSA Guidance Manual is required to be followed under the NAICs Risk Management and Own Risk and Solvency Assessment Model Act, which was adopted by the NAIC in September 2012. The NAIC's ORSA Guidance Manual requires an internal assessment of the risk associated with the insurer's current business plan and management's assessment of the sufficiency of capital resources to support those risks. The Guidance Manual, and insurers ORSA Summary Reports and risk management processes, are expected to evolve over the coming years. The ORSA process will be unique to each company, reflecting its business, strategy and approach to enterprise risk management (ERM).

In the EU, according to Art. 256, an annual ORSA is required of all entities at the solo level and at the group level that fall under the Solvency II regime but can also be required each time the company risk profile changes significantly. According to Art. 45, the ORSA assessment needs to cover at least: the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking; the compliance, on a continuous basis, with capital and technical provision requirements; and the significance with which the risk profile of the undertaking concerned deviates from the assumptions underlying the SCR, calculated with the standard formula or with its partial or full internal model. Also, the group ORSA has to explain the difference between the calculated capital requirement at the group level and the sum of the capital requirements of all

entities in the group. In other words it requires the insurance group to reflect on the outcome of the calculation of the group capital requirement and its own risk profile from a group perspective.

In the state-based regime in the U.S., the ORSA is required annually of larger insurers and insurance groups (collectively the entities required make up over 90% of the U.S. premium volume), and can be performed at either the solo level, or by the insurance group, provided all insurance legal entities within the group are included in the collective filings made available to the commissioner. In addition, the group capital assessment within the ORSA Summary Report may be requested throughout the year if material changes occur. The NAIC's ORSA Guidance Manual provides a framework, and allows discretion for insurers/groups to develop an ORSA process that is considered by management to be suitable and appropriate for their use. The process will be unique to each company, reflecting its business, strategy and approach to ERM. That will extend, according to the NAIC Guidance Manual, to include a company own approach to group capital assessment. The depth and detail is likely to be influenced by the nature and complexity of the insurer/group.

## Topic 4: Group System of Governance, Including Risk Management

### *Key Commonalities*

In both regimes, publicly listed companies have to comply with corporate governance requirements[16] (federal, state, and stock exchange).

In both regimes, if changes have occurred in risk management systems since the last examinations, or if there is a level of concern with respect to the insurer, the analyst or supervisor will follow up and assess the changes that have occurred in the insurer's risk management function, which could further impact the supervisor's plan as to the nature, timing or extent of additional analytical or examination processes.

### *Key Differences*

In the EU, according to Art. 246, all of the governance requirements of Art. 41 to 49 apply mandatorily at the solo as well as the group level. The system of governance in the Solvency II Directive imposes requirements with regard to two systems, the risk management system (including the ORSA) and the internal control system, as well as requirements on key functions. These must – at a minimum – include the risk management, compliance, audit and actuarial functions and must fulfil fit and proper requirements. The risk management and internal control system and reporting procedures have to be implemented consistently in all the undertakings included in the scope of group supervision so that those systems and reporting procedures can be controlled at the level of the group.

For the state-based regime in the U.S., governance requirements apply most directly at the solo level, but the IHC Model Act provides for review of information and approval pertaining to the ultimate controlling person and, if a corporation, its officers and directors. Holding companies, subsidiaries and affiliates are also subjected to general state laws pertaining to governance, and those that are publicly listed are also subjected to additional requirements by the stock exchanges as well as to federal laws (e.g., the Sarbanes Oxley Act) and regulations (e.g., by the Securities and Exchange Commission).

The state-based regime in the U.S. considers enterprise risk in many ways, including through the IHC Model Act, the proposed Risk Management and ORSA Model Act, but also through additional inquiry including within the risk-focused surveillance process. The IHC Model Act requires the ultimate controlling person/entity to file an annual Enterprise Risk Report which identifies to the best of their knowledge and belief, the material risks within the insurance holding company system that could pose enterprise risk to the insurer. In that context, the Act defines "enterprise risk" as any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole, including, but not limited to, anything that would cause the insurer's RBC to fall into company action level.

In the EU, the insurance group is viewed as an economic entity in and of itself and therefore group risk will reflect all the risks to which the group is or may be exposed. In the U.S., the proposed Risk Management and ORSA Model Act requires the insurer to maintain a risk management framework to assist the insurer with identifying, assessing, monitoring and reporting on its material and relevant risks. The requirement may be satisfied if the insurance group of which the insurer is a member maintains a risk management framework applicable to the operations of the insurer. Finally, as noted above, the states' coordinate their on-site examination procedures, including an assessment of the group's corporate governance structure, group-level financial control policies and procedures, and risk management framework. This review is characterized as an assessment versus a compliance review, and leads the examiners to then tailor their examination procedures according to the strengths and weaknesses of the group's governance and risk management systems.

## Topic 5: Colleges - Delegation of Powers to Group Supervision/Supervisory Powers at Group Level/the Group-Wide Supervisor Concept

### *Key Commonalities*

In both regimes a group-wide/lead supervisor/regulator concept and the supervisory college concept (initiating, membership, participation, function, on-going activities, crisis management plans, information exchange), playing a major role in group supervision, have been established.

In the EU there has been a long-standing practice of cooperation between supervisors of all European insurance groups in Coordination Committees. This practice has been expanded upon and given a legal basis in Solvency II. Convergence is underway as state insurance regulators in the U.S. are designating group supervisors (also referred to as lead state regulators) to either lead or participate in supervisory colleges, and, going forward, when requirements for ORSA and enterprise-risk reporting by groups will be enacted.

***Key Differences***

The role, tasks, powers and content of the group-wide supervisor differ between the two regimes and are explained in the following sections.

## 5.1 Key Characteristics of the College System

### 5.1.1 Supervisory Collaboration:

The EU has a legally binding college system. Colleges have a long history and practice since their introduction with the Helsinki list in 2000. The Solvency II Directive institutionalises and reinforces this operating mode by establishing "colleges of supervisors" under the chairmanship of the group supervisor, selected according to the procedure described in the Solvency II Directive. Thus, in the EU, the responsibilities of the college are based in law and applied to all groups including those with international operations. In a number of cases in the Solvency II Directive, where a joint decision on an application is required, the supervisory authorities concerned are expected to do everything within their power to reach such a decision. However, if this does not seem to be possible, the Solvency II Directive assigns EIOPA, who is a non-voting member of all existing colleges, the role of binding mediator. The Solvency II Directive also introduces a range of provisions obliging all supervisors involved to exchange information automatically and on demand, and to consult before any important decision.

The state-based regime in the U.S. has a less formal, non-binding framework for facilitating supervisory collaboration and coordination across a group of insurers. The NAIC serves the states in a coordinating role with a lead state framework, which was further developed following the passage of the U.S. Financial Services Modernization Act in 1999 (a.k.a. Gramm-Leach-Bliley Act). With the introduction of the revised IHC Model Act, states are beginning to form supervisory colleges on an international and regional basis. The state-based U.S. regime does not contain a formal dispute resolution mechanism, as each state preserves its regulatory power over the licensed insurance entity; though, every effort is made to reach a joint decision on the appropriate regulatory course of action.

5.1.2 Determination of the Group Supervisor:

The EU regime prescribes the determination of only one group supervisor who is appointed from among the supervisory authorities involved in the supervision of the group in accordance with Art. 247 and usually by the supervisory authority which has authorised the insurance or reinsurance undertaking that heads the EU group. The criteria for determining the group supervisor may be deviated from in certain situations and subject to a joint decision by the college of supervisors. EIOPA may be consulted and in the case of a dispute in the college, EIOPA will give advice during a process of binding mediation. As a consequence, for each group, a single authority is appointed with powers of decision and coordination.

In the state-based regime in the U.S., the designation criteria are set forth in the NAIC *Financial Analysis Handbook*. Historically, there may have been more than one state designated as a lead state; however, recent NAIC initiatives (e.g., revised IHC Model Act, enhanced accreditation standard regarding financial analysis) have had the effect of reducing the number of states designated as such. Presently, all U.S. insurance groups with an international presence have a single lead state, with a few exceptions.

The NAIC *Financial Analysis Handbook* provides guidance regarding the role of the lead state; however, the lead state does not possess any additional regulator powers.

5.1.3 Duration of Supervisory Colleges:

In the state-based regime in the U.S., the IHC Model Act provides that a college can be temporary or a permanent form for communication and cooperation; however, as a practical matter in operation they are permanent. In the EU a college is permanent.

## 5.2 Actions and Powers of Lead/Group Supervisors

***Key Commonalities***

In the EU, Art. 258 provides that where it is necessary the group supervisor can apply enforcement measures at the level of the insurance holding company. Where the group supervisor is not one of the supervisory authorities of the Member State in which the insurance holding company or the undertaking has its head office the group supervisor shall inform those supervisory authorities of its findings with a view to enabling them to take the necessary measures. Under Solvency II all Member States are required to ensure that sanctions can be imposed on insurance holding companies and persons managing those companies where Solvency II measures have been infringed. In the state-based regime in the U.S. there is no similar mandate, but the practice has been similar, i.e., that where the lead state/group supervisor (or any state supervisor overseeing a (re)insurance undertaking that is part of a group) sees the need to take action with respect to a holding company located outside

their state, they communicate with the state insurance regulator in that state with the view to enabling them to take the necessary measures.

In both regimes, there are limitations as to the ability of a lead state/group supervisor to take action on an extra-territorial basis. Both regimes therefore rely on communications and coordination with supervisors in other jurisdictions, a process which is enhanced through supervisory colleges.

***Key Differences***

The EU regime provides for certain legally binding rights and duties of the group supervisor. Under Solvency II, the group supervisor oversees the review and assessment of the financial situation of the group; of its compliance with the rules on solvency and of risk concentration and IGTs; of its system of governance including the group-wide risk management, internal controls, reporting procedures and Group ORSA, fit and proper requirements of key individuals; planning and coordination of supervisory activities in going concern as well as in emergency situations, in cooperation with other supervisory authorities concerned; and serving as chair of the college of supervisors. In the EU the dialogue at the group level is conducted by the group supervisor; the legal entity supervisor is responsible for the supervision of its national legal entity, but not for the communication towards the parent company. The solo supervisor will provide the group supervisor with any relevant data for his tasks and vice versa. The group supervisor uses the college as a platform for cooperation, exchange of information and consultation processes.

The U.S. lead state, or host states generally, do not possess regulatory powers to take over or pull the license of a holding company. Rather, the lead state assists other states in coordinating analyses and regulatory reviews of insurance groups. There is an increased focus on conducting coordinated on-site examinations, whereby selected solo insurers within a group (or at least those under common management, systems, controls and risk management) would be examined concurrently; such efforts are coordinated and led by the lead state. The lead state reviews and assesses the financial situation of the group. The lead state and the host state have review and pre-approval authority of significant IGTs involving insurers of the group that are domiciled in their respective states. Each domestic state has a holding company act in place that provides for the filing of information to assess the qualifications of owners and senior management. In addition, and going forward under the recent changes to the IHC Model Act (when enacted by states), the state insurance regulator will have the ability to examine the insurer's affiliates as reasonably necessary to ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis, or to determine compliance with the holding company act. With forthcoming enabling legislation, states will also have access to ORSA reports as to be regularly performed by larger groups and undertakings.

There also are the following key differences between the two regimes:

- The manner in which the group supervisor is determined is set forth in law in the EU; in the state-based regime in the U.S. the lead state regulator (it could be more than one) is determined through an established process administered by the NAIC.

- In the EU the group supervisor has specific powers on legal entities and the group itself (holding company located in the EEA).

- In the EU, in an EU college, the group supervisor has responsibilities, some stemming directly from EU law, others delegated from the colleges' members, including the final decision making within an established process. In the state-based regime in the U.S., the lead state may work collaboratively with the other states with domestic insurers in the group.

- In the EU, the group supervisor may request that the holding company acquire more capital; in the state-based regime in the U.S., if group capital concerns exist they are addressed through regulatory pressure on the holding company's insurance subsidiaries.

- EU Member States may rely on the group supervision exercised by a third country supervisory authority over a group headquartered in their jurisdiction where the group supervision regime is found to be equivalent to that under Solvency II.

**Topic 6: Federal Supervision in the U.S. of Financial Conglomerates that own Depository Institutions and Insurance Groups, and Supervision of Financial Conglomerates in the EU**

The preceding discussion in this TC2 report compared the current state-based insurance regulatory regime in the U.S. to the Solvency II regime in the EU with respect to group supervision. In addition, for certain insurance groups – those that are controlled by companies that also own a bank or savings association and are thereby defined as BHCs or SLHCs – consolidated supervision is provided at the federal level in the U.S. by the Federal Reserve. That means that this approach is not applicable to purely insurance groups.

Specifically, the Federal Reserve applies "consolidated supervision" to all BHCs and to all SLHCs with a particular emphasis on protecting the depository institution. Such consolidated supervision is established under the "functional regulatory" regime set forth in U.S. law under the Bank Holding Company Act and the Savings and Loan Holding Company Act. Such consolidated supervision currently applies to about 25 insurance companies that own a bank or savings and loan association. The Federal Reserve, as the "umbrella supervisor" under the functional regulatory regime in the U.S., directly supervises such BHCs and SLHCs on a consolidated basis, including all subsidiaries and their relationships with joint ventures and other non-controlled companies. Under this regulatory framework, the Federal Reserve generally defers to the "functional regulator" of the regulated subsidiaries. These functional

regulators include state insurance regulators directly supervising insurance companies and the federal banking agencies (Office of the Comptroller of the Currency and FDIC) directly supervising bank or thrift subsidiaries of a BHC or SLHC, respectively.

The Federal Reserve has legal authority, initially granted under the Gramm-Leach-Bliley Act and strengthened by the Dodd–Frank Act, to obtain reports directly from, and take direct supervisory and enforcement action with regard to, functionally-regulated subsidiaries. The Federal Reserve exercises this authority if it determines that it is necessary to take such action in accordance with statutory criteria. Furthermore, the Federal Reserve exercises direct supervision over subsidiaries that do not have a direct functional regulator, whether within or outside of the United States.

Those BHCs and SLHCs subjected to consolidated supervision by the Federal Reserve are statutorily required to comply with consolidated capital requirements under the Federal Reserve's capital rules. These capital requirements generally are the same as the capital requirements imposed by all three federal banking agencies on banks and thrifts. These standards are based on the Basel Accord, including the Basel I, II, II.5 and III agreements. The supervised insurance companies within these holding companies continue to be subject to the solo insurance capital requirements imposed by the state insurance regulators.

Furthermore, under the Collins Amendment, adopted as section 171 of the Dodd-Frank Act, all BHCs and SLHCs are subject to minimum consolidated capital requirements on all assets. These assets include all assets of insurance companies that are also subject to insurance capital requirements under the NAIC RBC framework. Accordingly, the leverage and RBC requirements applicable to banks sets a floor capital requirement for all BHCs and SLHCs without regard to the capital requirements applied by state insurance supervisors. The only possible exception is that the Federal Reserve and the FDIC are authorized under their rules implementing the Collins Amendment to agree to impose a lower capital requirement on certain assets (e.g., non-guaranteed separate accounts) not generally found on a bank's balance sheet.

Finally, the Federal Reserve applies a supervisory college concept in its interactions with other involved functional regulators and other supervisors, including financial supervisors in countries other than the United States.

In the EU, Solvency II Directive requirements regarding group supervision apply to all insurance groups (regardless of whether depository institutions or thrifts are members of the group).

On 20 November 2002[17] the EU adopted the Financial Conglomerate Directive (so called FICOD). FICOD ensures that financial conglomerates are supervised on a group-wide basis and supplements the rules contained in the sectoral legislation on banking/investment and

[17] Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (FICOD).

insurance. The Directive follows the Joint Forum's principles on financial conglomerates of 1999[18].

The FICOD in particular includes requirements and techniques for assessing the capital adequacy of conglomerates, including detecting multiple gearing; facilitating the exchange of information among supervisors; coordination among supervisors; testing the fitness and propriety of managers, directors, and major shareholders of the conglomerate; and the prudent management and control of risk concentrations and intra-group transactions and exposures.

The EU recently undertook a first review of FICOD (so called FICOD1) following the lessons learnt during the financial crisis of 2007-2009. FICOD1[19], which was adopted in November 2011, amends the sector-specific directives in such a way that supervisors are now able to perform consolidated banking supervision and insurance group supervision at the level of the ultimate parent entity where that entity is a mixed financial holding company. In addition, FICOD1 revised the rules for the identification of conglomerates, introduced a transparency requirement for group's legal and operational structures, and requires the inclusion of alternative investment fund managers into the scope of supplementary supervision in the same way as asset management companies.

FICOD1 requires the EC to deliver a review report before 31 December 2012 addressing in particular the scope of the Directive, the extension of its application to non-regulated entities, identification criteria of financial conglomerates owned by wider non-financial groups, systemically relevant financial conglomerates and mandatory stress testing. The review, which is currently in the process of being prepared by the EC, will be followed up by legislative proposals if deemed necessary.



[18] The Joint Forum is the joint body of the international standard setters: Basel Committee for Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Committees (IOSCO).

[19] Directive 2011/89/EU, amending Directives 98/78/EC ("IGD"), 2002/87/EC [FICOD], 2006/48/EC "CRD") and 2009/138/EC ("Solvency II") as regards the supplementary supervision of financial entities in a financial conglomerate.

## 3. Solvency and Capital Requirements

**Executive summary:**

The primary objective of both regulatory regimes is to protect the policyholders. For this purpose, the two regimes have two different approaches. Under the state-based regime's risk-based capital (RBC) system in the U.S., the Company Action Level (CAL) sets a minimum amount of capital before corrective action is prompted. That amount of regulatory capital is likely to be lower than the EU Solvency Capital Requirement (SCR). The CAL RBC level (and the three other levels) for regulatory intervention is not calibrated to an overarching confidence level or time horizon (calibration of risk categories are also not derived from explicit target criteria). Under the EU Solvency II regime, the supervisory ladder of intervention is based on the SCR and the Minimum Capital Requirement (MCR) which are calibrated to 99.5% and 85% confidence levels respectively, using a value-at-risk measure of the Basic Own Funds derived from a total balance sheet approach. The Mandatory Control Level RBC is most likely lower than the Solvency II MCR[20].

The term "internal models" indicates a different meaning under the state-based regime in the U.S. than it does under Solvency II, and the scope of application of models is more limited under the RBC system in the U.S. than it is under Solvency II. Specifically, RBC limits the application of models in the U.S. to specific products and risk modules, using prescribed parameters and time horizons and the models are not subject to a prior approval by the supervisor, though they are subject to regulatory minimum/floor scenarios. Under Solvency II, as a way to more precisely reflect the risk profile of the regulated entity, internal models can be used for the calculation of the SCR for all or some of the risks. The use of internal models is subject to prior supervisory approval, ongoing monitoring and compliance with specific requirements including the integration of the model in risk management and decision making processes.

Both regimes have a similar concept of the own risk and solvency assessment (ORSA), but the EU sets in law the process and prescribes that the qualitative and quantitative assessments are performed against a set standard. The EU also provides guidelines that are more prescriptive. In the U.S., more management discretion is allowed as to the use of methodologies, with disclosure and justification.

The state-based regime in the U.S. and Solvency II deviate from the accounting treatment (respectively, U.S. GAAP and IFRS) in valuing certain assets and liabilities. The former looks to establish more of a winding-up value based on the statutory accounts and the use of amortized cost methodologies, whereas the EU regime assesses a company on a going-

[20] MCR floor (the middle of the corridor) corresponds to 70% ACL (35% RBC). Therefore if the amount of regulatory capital is likely to be lower in the US than the EU SCR, Mandatory Control Level is likely to be lower than MCR as well.

concern basis based on a market consistent balance sheet. This difference is consistent with the SCR potentially being an earlier intervention point than the RBC CAL and explains why available capital is likely to be more subject to variation over time in response to changing market conditions under the European regime.

Technical provisions are valued on a market-consistent basis under Solvency II. Technical provisions comprise the sum of the best estimate and a risk margin. The best estimate represents the probability weighted average of all future cash flows discounted using a risk free rate term structure. The risk margin represents the cost of capital to support the product until liabilities are fully run-off. The RBC regime by contrast uses a discount rate based on corporate bond yields for life insurance reserves and a best estimate (for which discounting is restricted to certain lines of business) for property & casualty insurance reserves and has no equivalent for the risk margin concept. The reserving bases are different and an assessment of the relative strength of the EU and U.S. bases will depend on the specific product under consideration.

Under RBC requirements, capital is defined as statutory capital and surplus with prudential adjustments (including ones made for non-admitted and limited admissibility assets). In the EU, capital resources are generally equal to the net asset value of the firm plus subordinated liabilities (basic own funds) and ancillary own funds. Solvency II includes a three-tier classification of capital and provides specific provisions for the classification of hybrid and subordinated capital instruments. To the extent that instruments do not provide the best form of loss absorbency, they are restricted in counting towards covering capital requirements.

Investment restrictions are consistent with the prudent person principle under Solvency II. In the state-based regime in the U.S., investment restrictions are based upon defined limits or a prudent person approach (or some combination) depending on the state. For RBC results, corrective actions are triggered when the capital resources of a company are less than the Company Action Level RBC, while, under Solvency II capital requirements, corrective actions are triggered when a company breaches its SCR.

**Topic 1: Policy Objectives**

*Overall Policy Objectives*

The primary objective of both the state-based regulatory regime in the U.S. and the EU's Solvency II is to protect policyholders. The protection of policyholders presupposes that companies are subject to effective solvency requirements that result in the maintenance of adequate capital resources that cover all of the risks to which an insurer is or could be exposed. Accordingly, capital requirements are a key tool for accomplishing the objective of policyholder protection under both regimes. Financial stability and fair and stable markets are

other objectives of insurance regulation and supervision that should also be taken into account but that should not undermine the main objective.

*Overall Policy Framework & Supervisory System*

Under the state-based regime in the U.S., RBC requirements are a tool for legally authorized and defined company or regulatory action at specified levels. State regulators also have regulatory authority for Companies Deemed to be in Hazardous Financial Condition (NAIC Model 385) to impose tailored timely intervention (pursuant to other solvency tools) prior to an RBC action-level trigger. RBC sets out a minimum capital requirement and does not aim to be an evaluation of economic or target capital level. Therefore, it is not used to establish or compare well-capitalized companies. RBC requirements target material risks for each of the primary insurer types (life, property & casualty and health).

In addition to RBC requirements and other financial tools used to implement corrective action, the overall state-based solvency framework in the U.S. also includes the following: restrictions on insurers' activities to mitigate or eliminate some risks in the insurance business; prudential accounting filters which result in conservative surplus recognition and provide counter-cyclical effects[21]; and a back-stop of financial protection when insurer rehabilitation or liquidation is required via the State Guaranty Fund System. As such, RBC is calculated from valuations that are usually more conservative (e.g., non-admitted assets, deferred acquisition costs are expensed rather than capitalized) and less volatile (e.g., many fixed income instruments are valued at amortized cost) than valuations under financial accounting standards such as GAAP. Insurer risk management issues are addressed in multiple areas outside of RBC, most heavily in the on-site examination process (see TC 7)[22] but also in reporting and analysis (see TC 5)[23]. As discussed further below, state regulators may also impose additional capital requirements (for example, for deficiencies in risk management and other areas) outside of the RBC calculation.

In the EU, Solvency II follows a "Total Balance Sheet Approach" where the determination of an insurer's capital that is available and needed for solvency purposes is based upon a market consistent or economic valuation approach. Solvency II capital requirements target all quantifiable risks and are determined on the basis of the risk profile of the company and the management of those risks (e.g. the use of risk mitigations). Solvency II capital requirements therefore provide incentives for sound risk management practices and enhanced transparency

[21] One example of a counter-cyclical effect is the Asset Valuation Reserve, which life insurers set aside to offset future credit-related losses on investments. Another example is the valuation of investment assets on an amortized cost instead of a fair value basis.

[22] In particular, examiners are required to gain an understanding of the corporate governance structure and to assess the undertaking's risk management environment. Deficiencies and concerns are presented to management and progress on corrections is monitored with the potential for escalating regulatory intervention.

[23] Reporting requirements address, among other issues, whether a company has a code of ethics for senior management, an Audit Committee per state laws, Board of Directors' oversight of investment purchases and sales. Regulators follow up on the findings of exams and might assess whether the Board has an appropriate level of oversight and if any changes have occurred to the Board structure, committees, etc.

(*e.g.*, in the case of governance deficiencies, supervisors may impose capital add-on – see *Capital add-on* below).

***Key Commonalities:***

- RBC in the state-based regulatory regime in the U.S., and Solvency II capital requirements in the EU, play a key role in meeting the goal of policyholder protection, which is central to both regimes.
- Both regimes provide thresholds for regulatory actions.
- For both regimes, the capital requirements are supported by requirements on governance, supervisory review, reporting to supervisors. In addition, both rely on market discipline through public disclosure.

***Key differences:***

- The Solvency II market-consistent balance sheet provides a going-concern view of an insurer's solvency position, while RBC represents capital more on a winding-up basis, thereby influencing the part they play in the respective regimes.
- The SCR under Solvency II includes all quantifiable risks of the insurer while RBC includes risks considered material to the industry with some modules looking at company specific assumptions.
- The Solvency II framework, including the SCR, is designed to provide incentives for risk management, whereas the RBC primarily relies on supervisory tools other than capital requirements to address risk management concerns.

**Topic 2: Assessment of Risk and Capital Adequacy**

*Scope of regulatory capital calculation*

The RBC calculation under the state-based regime in the U.S. is mainly a standardized approach tied to annual statement data with increasing use of internally-generated company information for model approaches. RBC assesses risk by applying risk weights (called "factors") within each risk module, although, certain lines of business and risks (e.g. interest rate risk) are assessed using models (see further discussion of models below in Topic 4).

Each of the primary insurance types (life, property & casualty, and health) has a separate RBC formula, with each containing its own set of factors covering the material risks identified in each formula. The components of the life insurance formula include the following: risk related to certain affiliated investments[24]; risk on other financial assets (e.g.

[24] An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the

risk of default, change in market value); insurance risk; interest rate, health credit risk, and market risk[25]; and general business risk. The components of the property & casualty insurance formula include: risk related to affiliated company investments; risk on fixed income assets; risk on equities; credit risk (related to reinsurance recoverables); underwriting risk (related to reserves); and underwriting risk (related to net written premium). The components of the health insurance RBC formula include the following: risk related to certain affiliated investments; risk on other financial assets; underwriting risk; credit risk[26]; and business risk.

Asset concentrations are also assessed via risk charges to reflect the additional risk of high concentrations in single issuers. However, currency risk is not taken into account and catastrophe risk is not addressed directly and completely, although a catastrophe risk charge currently is being developed as part of Solvency Modernization Initiative[27]. A standard factor for operational risk is included in the Life RBC formula, but not in the P&C formula.

The RBC formula includes a covariance calculation (that also varies depending on line of business) that is designed to measure correlation between risks. Affiliated investments are excluded from the covariance calculation based upon the assumption that diversification disappears when the entity experiences financial distress[28].

Four RBC action and control levels establish risk-based requirements that provide a baseline to more discretionary regulatory intervention resulting from analysis and examination oversight activities (see Topic 4 for additional discussion of the RBC action and control levels).

In the EU, the Solvency II framework sets out two different levels of capital requirements, an upper level, the SCR, and a lower bound, the MCR.

The SCR is designed to take into account all quantifiable risks to which a firm is exposed, to include at least the following: (life, non-life and health) underwriting risks; market risk; credit risk; operational risk. Each of these risks includes various sub-risks. For instance, market risk includes interest rate risk, equity risk, property risk, spread risk, currency risk, and market

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reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity. (Person in this context includes individuals as well as corporate structures.)

[25] Market risk in this context covers risk of losses due to changes in market levels associated with variable products with guarantees.

[26] Credit risk in this context refers to the risk that health benefits prepaid to providers become the obligation of the health insurer once again.

[27] The separate catastrophe risk charge is currently planned for the 2013 Property & Casualty RBC formula. The new parameters will apply immediately from the time the formula is updated, no further sign-off at State Level is required.

[28] Excluding the capital charge on affiliated investments from the covariance calculation ensures that more capital is held for these affiliated investments (*i.e.* the RBC charge is not smoothed by the covariance calculation), which partially addresses the double gearing of capital.

risk concentration. The SCR takes into account risk mitigation techniques (*e.g.* reinsurance) provided that credit risk and other risk arising from the risk mitigation are also reflected in the SCR. The SCR is a risk-sensitive requirement used for timely supervisory intervention (to prompt corrective action by the company).

Please refer to appendix A for more details on risks covered and approach adopted under RBC and Solvency II SCR standard formula calculation.

The MCR is designed to correspond to a minimum solvency level, below which policyholders and beneficiaries are exposed to an unacceptable level of risk, if the insurer were allowed to continue its operations. The MCR is a simple linear formula, calculated independently from the SCR calculation, comprising a set of risk factors applied to the individual company liabilities. The MCR must be within 25% and 45% of the SCR and is subject to absolute minimum amounts.

As an alternative to using the SCR standard formula, a company may, subject to regulatory approval, replace some parameters of the underwriting risks modules with some other parameters based on the company's own data. In accordance with the risk-oriented approach to the SCR, companies can, subject to supervisory approval, use either partial or full internal models for the calculation of that requirement (this is reflected in a separate section).

The framework is completed with the existence of dampeners, both quantitative (e.g. the symmetric adjustment mechanism for equity risk under the standard formula) and qualitative (e.g. provision for taking due care to avoid pro-cyclical effect when requiring plan to restore compliance with the SCR), that aim to address potential pro-cyclical effects of the regime.

*Calibration of regulatory capital*

There is no overall formula calibration under RBC. Instead, state regulators refine individual risk weights through analysis of historical data and probabilities using expert judgment. A separate calibration process is applicable to partial models used to assess interest rate and other risks. In short, RBC factors were developed based on industry norms with some factors adjusted by company specific experience. Risk weights, partial model calibration, and any other formula change are accomplished via a transparent process incorporating input from insurance market representatives.

Under Solvency II, the MCR uses a standardized approach based upon Value at Risk calibrated to an 85% confidence level over a 1-year time horizon. The SCR is based upon Value at Risk calibrated to 99.5% confidence level over a 1-year horizon for all risk modules and for the overall formula. The outputs of the modules (and submodules) of the standard formula are calibrated to the 99.5% Value at Risk over a 1-year horizon and then aggregated using a prescribed variance/covariance matrix based upon fixed correlation factors between risk modules. This has been calibrated using a combination of data and regulatory judgment.

The calibration was developed through a transparent process involving insurance market representatives via public consultations and was tested through quantitative impact studies.

*Frequency of calculation of the regulatory capital*

RBC is an annual filing to the NAIC. However, supervisors may require more frequent filings directly to the state for undertakings of concern (typically quarterly).

Under Solvency II, a company is required to calculate the SCR at least once a year, but may be required to do so more frequently if the risk profile of the firm deviates (or there is evidence to suggest that it has deviated) significantly from the assumptions underlying the last reported SCR. The frequency of calculation of the MCR is at least quarterly.

*Capital Add-on to regulatory capital*

Under Solvency II, supervisors have the power to impose a capital add-on to the SCR following the supervisory review process. Capital add-ons may be imposed where the risk profile of the firm deviates significantly from the assumptions underlying the SCR as calculated using the standardised approach or the internal model in order to restore the firm to the 99.5% confidence level, using a value-at-risk measure. Capital add-ons may also be imposed where there are significant governance deficiencies. In the event the standardised approach does not adequately reflect the specific risk profile of an undertaking supervisor may require the development of an internal model[29]. In the event of significant deficiencies in the full or partial internal model or significant governance failures the supervisors ensure that the insurer makes every effort to remedy the deficiencies that led to the imposition of the capital add-on. The capital add-on should be retained for as long as the circumstances under which it was imposed are not remedied.

Under the Hazardous Financial Condition model regulation, state insurance regulators in the U.S. have the discretion to impose additional capital requirements when one or any combination of twenty listed standards is breached. The additional capital is not an increase to the RBC calculation. Instead, it is an increase to the level of capital the insurer is actually holding and therefore becomes an effective minimum capital requirement. Furthermore, state regulators are in the process of implementing a trend test under RBC (described below under Topic 3). Triggering the trend test can result in the regulator asking insurer to hold more capital[30]. Disclosure of trend test results is not foreseen at this stage.

See TC2 report for a description of group capital requirements.

[29] Under Solvency II standard formula is not calibrated to industry average; it is calibrated to value at risk with confidence level 99.5% and 1 year time horizon. Therefore if the insurer uses internal model (after supervisory approval) to calculate the capital requirements, it will not affect calibration of standard formula.
[30] Solvency ratio of the insurer will not change.

*Own Risk Solvency Assessment (ORSA) and economic capital*

The states, through the NAIC, are in the process of implementing an ORSA standard. According to the Risk Management and Own Risk and Solvency Assessment Model Act that is currently being adopted, the ORSA summary report shall be prepared consistent with the ORSA Guidance Manual. Section 3 of the NAIC ORSA Manual refers to Group Risk Capital and Prospective Solvency Assessment and sets the goal of the assessment to provide an overall determination of group risk capital needs for the insurer, based upon the nature, scale and complexity of risk within the group and its risk appetite, and to compare that risk capital to available capital to assess capital adequacy. According to the interpretation of NAIC experts also, a legal entity that does not belong to a group is not exempted from having to complete section 3. In the EU, ORSA is Solvency II directive requirement. Under both regimes, ORSA will encompass the processes and procedures used to identify, assess, monitor, manage and report the short and long term risks a (re)insurance company faces or may face and to determine the capital adequacy (including a prospective solvency assessment) from the company-own perspective. Both regimes have an ORSA requirement that is similar in concept, but the EU sets by Directive the process and prescribes the qualitative and quantitative assessments that have to performed, and provides guidance that are more prescriptive, whereas in the U.S., more management discretion is allowed as to the use of methodologies, with disclosure and justification.

In the EU, the ORSA is an integral part of the risk management and shall be taken into account on an on-going basis in the strategic decisions of the insurer. According to Art. 45, the ORSA will need to cover at least: the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking, the compliance, on a continuous basis, with the capital requirements, and with the requirements regarding technical provisions, as well as the significance with which the risk profile of the undertaking concerned deviates from the assumptions underlying the SCR, calculated with the standard formula or with its partial or full internal model. The ORSA will essentially provide that all companies, regardless of the solvency calculations required by supervisory regulations, are required to determine their actual risk profile realistically based on economic criteria and to control the same and integrate it into their risk management processes.

Under the state-based regime in the U.S., the ORSA is one element of an insurer's broader Enterprise Risk Management (ERM) framework[31]. The ORSA requirement includes an exemption for insurers with annual premium revenue less than $500 million but this is subject to commissioner discretion. The NAIC's ORSA Guidance Manual requires an internal

[31]The inclusion of ORSA into the state-based regime of solvency regulation is set forth in the SMI Action Plan. Pursuant to that plan, the ORSA Guidance Manual has already been completed and adopted by the NAIC. The Risk Management and Own Risk and Solvency Assessment Model Act was adopted by the full NAIC membership on Sept. 12, 2012 and will be implemented on January 1, 2015. The model references the ORSA Guidance Manual and establishes the requirement to provide information that meets the minimum coverage and components prescribed in the manual. Individual states will begin adopting the model into their statutes in 2013.

assessment of the risk associated with the insurer's current and projected future business plan and an assessment of the sufficiency of capital resources to support those risks in both the current and stressed environments. As specified in the ORSA Guidance Manual, the ORSA Summary Report should discuss, at a minimum, the three major areas of: 1) a description of the insurer's risk management framework (including at a minimum the risk culture and governance; the process for risk identification and prioritization; the risk appetite, tolerances and limits; the description of risk management and controls; and risk reporting and communication); 2) the insurer's assessment of risk exposure (quantitative and qualitative assessments of risk exposure in both normal and stressed environments for each material risk category); and 3) the group risk capital and prospective solvency assessment (documenting how the company combines the qualitative elements of its risk management policy and the quantitative measures of risk exposure (in both normal and stressed environments) in determining the level of financial resources it needs to manage its current business and over a longer term business cycle such as the next 2-5 years).

For group ORSA requirements, see the TC2 report.

Although economic capital targeted by insurers for commercial purposes is higher than the regulatory capital requirements in both regimes, SCR generally yields a regulatory capital requirement that is closer to such economic capital than RBC for companies targeting the same credit rating.

*Key Commonalities:*

- Both regimes calculate risk-based capital requirements based on a company's own risk profile. However, the risk factors included in RBC are established to cover risks that are material for the industry, while the SCR of the Solvency II regime should cover all quantifiable risks to which a company is exposed.
- Both regimes have an ORSA requirement that is similar in concept.
- Both allow some modification of the standard formula calculations for company-specific experience (using undertaking-specific parameters under Solvency II or weighted company-own factors under RBC).
- Both regimes allow regulators the discretion to impose capital add-ons. The state-based regime in the U.S. allows use of capital add-ons in specific situations deemed hazardous to the undertaking's financial condition. The insurer is required to hold the additional capital, and this becomes the firm's minimum regulatory capital. Triggering the RBC trend test can also result in regulator asking an insurer to hold more capital. Solvency II demands an explicit increase to the insurer's regulatory capital, through the use of capital add-ons where there are significant governance failures or where the risk profile of the firm is significantly different from the assumptions underlying the SCR calculation. The capital add-on is imposed in order to restore the regulatory capital to a 99.5% confidence level.

*Key differences:*

- Solvency II provides for a risk-sensitive capital requirement (SCR) that is based upon a prospective calculation of capital charges calibrated to an overall value at risk with a confidence level of 99.5%. RBC is not based on an overarching calibration target, although it does provides for specific calibration at individual risk level.
- RBC capital requirements cover a specified list of factors that focus on the most material risks at the industry level and that are differentiated by type of insurer (life, P/C, health). The SCR is required to take into account all quantifiable risks for a firm The MCR is a linear formula based on a set of risk factors applied to individual company liabilities, and is much simpler than either the SCR or RBC.
- While an ORSA will exist in both regimes, the primary difference is that in the EU ORSA is a more prescriptive legal requirement linking risk management and capital management (including assessment of the significance with which the risk profile of the undertaking deviates from the assumptions underlying the SCR), whereas under RBC it is a legal requirement tied to analysis and regulatory oversight with more discretion initially left to management to determine (and justify) the specific risk assumption and mitigation methodologies chosen.
- Under Solvency II, supervisors may impose an additional capital add-on to increase the SCR to the calibration target and the resulting SCR will be disclosed. Under RBC, the regulators may require a company to hold a higher level of capital if the trend test is triggered. Additional capital outside than the RBC calculation may be required, but that does not constitute an increase to the RBC calculation.
- Currently, currency risk and catastrophe risk are excluded from RBC, although there are plans to include catastrophe risk as part of SMI; it is planned that the 2013 formula will capture this. A standard factor for operational risk is included in the Life RBC formula, but not in the P&C formula. Since the overwhelming majority of business written by US domiciled insurers is in US currency, currency risk is not currently a material risk for the industry and thus is not incorporated into the RBC formulas. It is noted though, that bilateral EU–US recognition may result in an increase of EU–US cross-border business. For a particular undertaking that has a material amount of currency risk, this would be disclosed as part of the required statutory financial statement and monitored by the supervisor in the analysis and examination processes.

**Topic 3: The Role of Capital**

*Levels of Regulatory Intervention*

Under the state-based regime in the U.S., the RBC calculation is a standardized approach to measuring a minimum amount of capital for an individual company by applying factors to the

individual company's risk profile. A single RBC calculation is used to establish different levels of action points and authorizes a specific and escalating ladder of regulatory actions for poorly capitalized companies. Specifically, the RBC formula generates a required level of capital and surplus unique to each company based on the specific risk profile of each company. From this formula, the RBC generates the Authorized Control Level (ACL) RBC[32], which is used to generate the three other action and control levels. Total Adjusted Capital (TAC) for a company is calculated based upon adjustments to the company's actual capital and surplus. The ratio of an insurer's TAC divided by its ACL RBC is compared to the four action and control levels. States are currently in the process of implementing trend test which is calculated at the level above the CAL RBC, using a 200% - 300% of ACL RBC range, but incorporating other requirements that differ by insurer type. Triggering of the trend test requires the insurer to respond as if the Company Action Level RBC was triggered.[33]

Under Solvency II in the EU, two independently calculated capital levels are established to allow for an effective supervisory ladder of intervention:

- SCR, establishes a uniform level of safety for all insurers, the breach of which triggers supervisory intervention to prompt corrective actions approved by the supervisor (*e.g.* de-risking, raising new capital).
- MCR, establishes a minimum level of capital, the breach of which requires supervisory actions, which may include withdrawal of insurance license.

**Types of intervention**

| RBC - Action Level | RBC - Level of regulatory intervention | Solvency II | Solvency II – Supervisory action |
|---|---|---|---|
| **CAL** TAC between 150% and 200% of ACL | CAL requires the company to prepare and submit an RBC Plan to the commissioner of the state of domicile. After review, the commissioner will notify the company if the plan is satisfactory. | SCR | The company shall inform the supervisor of any non-compliance or risk of non-compliance in the next 3 months. Within 2 months from non-compliance the company shall submit a recovery plan for |

[32] Authorized Control Level (ACL) RBC is used to calculate the other levels: CAL RBC = 2 x ACL RBC; Regulatory Action Level RBC = 1.5 x ACL RBC; ACL RBC = ACL RBC; and Mandatory Control Level RBC = .7 x ACL RBC.

[33] These trend tests are already incorporated into the RBC formula calculations and States can use the data in analysis. However, the states are in the process of adopting the trend test changes to the RBC Model Law (adding a trend test for P&C and modifying the trigger from 250% to 300% for Life). Thus, the legal authority to require a company to submit the RBC Action Plan based on the new trend test will not exist until the state adopts the amended RBC Model Law. For Accreditation purposes, all states must have adopted the property/casualty trend test for the 2012 RBC calculations that will be filed in 2013, whereas the life trend test adoption requirement will be 2015 or 2016 (final decision yet to be made).

| | | | |
|---|---|---|---|
| **RAL (Regulatory Action Level):** TAC between 100% and 150% of ACL | RAL requires the insurer to submit to the commissioner of the state of domicile an RBC Plan, or if applicable, a Revised RBC Plan. After examination or analysis, the commissioner will issue an order specifying corrective actions (Corrective Order) to be taken. | | approval by supervisor.<br>The supervisor shall require within 6 months from non-compliance to restore compliance (period can be extended by 3 months).<br>In exceptional circumstances, the supervisor may restrict or prohibit the free disposition of assets.<br>Tier 1 capital items (e.g. ordinary share capital) must start absorbing losses. It is envisaged that, unless exceptionally permitted by the supervisory authority: repayment or redemption of Tier 1, Tier 2 and Tier 3 capital items must be suspended; distributions relating to Tier 1 capital items must be cancelled; and distributions relating to Tier 2 capital items must be deferred. |
| **ACL (Authorized Control Level):** TAC between 70% and 100% of ACL | In addition to the above, ACL authorizes the commissioner of the state of domicile to take whatever regulatory actions (may include rehabilitation or liquidation) are considered necessary to protect the best interest of the policyholders and creditors of the insurer. | MCR (the MCR can be associated with both ACL and MCL; the RBC system includes more phases in this concept) | The company shall inform the supervisor of any non-compliance or risk of non-compliance in the next 3 months.<br>Within 1 month from non-compliance the company shall submit for approval by supervisor a finance scheme to restore compliance within 3 months.<br>The supervisor may restrict or prohibit the free disposition of assets.<br>It is envisaged that distributions relating to Tier 3 capital items must be deferred. |
| **MCL (Mandatory Control Level):** TAC < 70% ACL | MCL requires the commissioner of the state of domicile to take actions necessary to place the company under regulatory control (*i.e.*, rehabilitation or liquidation). | | |

*Key Commonalities:*

- Both regimes require plans of action within a specified time-frame and extensive regulatory interaction. Both have a supervisory ladder of intervention based on RBC ratios, SCR or MCR.

*Key Differences:*

- The RBC calculation is a standardized approach to measuring a minimum amount of capital used to calculate different levels of action points; it is not an indicator of financial strength. Solvency II includes two independently calculated capital levels (MCR and SCR) that allow different types of regulatory actions.

**Topic 4: Approaches to Internal Models**

The state-based RBC regime in the U.S. limits modeling to specific products and risk modules within an otherwise standardized approach. Partial models are limited currently to specific life and annuity products with guarantees that are subject to interest rate or market fluctuation risks. While these partial models are not subject to regulatory approval, regulators generally set or specify sources for companies to use prescribed statistical parameters and time horizons for the partial models and may apply a standard model that acts as a floor on capital. Documentation supporting modeling and decisions is also required at least annually and reviewed in the supervisor's oversight activities.

Under Solvency II in the EU, while an insurer must use a standardized approach in determining its MCR, it can choose between the standard approach or the use of an internal model for either specific risk modules (*i.e.* partial internal model) or for all its risks when determining its SCR. Internal models are considered as an approach to more precisely reflect the risk profile and as such serve as a valuable risk management tool. An insurer, however, must receive prior approval from its supervisor to be able to use an internal model. The initial approval of the application to use an internal model is subject to specific tests and standards covering the following: use tests; statistical quality standards; calibration (99.5% Value at Risk over 1 year); documentation; profit and loss attribution; and validation. Internal models are also subject to requirements regarding change governance and ongoing monitoring of its performance. Internal model approval can be granted only if the supervisors are satisfied that the company has an effective risk management system to identify, measure, monitor, manage and report risk, and the internal models are required to be embedded in an insurer's decision making process and risk management. Post-approval supervision is focused on assessing the ongoing compliance with tests and standards and appropriateness of the internal model to reflect the risk profile. In addition, where the standard formula does not reflect appropriately its risk profile, the company may be required to develop an internal model for all or part of its risks.

The requirement for the model to be internal (*i.e.* embedded in the internal processes of the firm) is very important to the framework in order to create incentives to improve the quality of the internal model.

*Key differences:*

- Solvency II provides the options for a firm to model some or all of its risks in order to more precisely reflect its risk profile. RBC limits modeling to specific products and risk modules within an otherwise standardized approach.
- Under Solvency II, prior approval of models by supervisors is required. The SCR calculation using an internal model must be calibrated to the same confidence level as the standard formula. Approval to use an internal model is subject to the company demonstrating compliance with tests and standards and appropriateness of models chosen. Models used within RBC do not require prior approval but generally are subject to prescribed parameters or limits set by supervisors.
- Under solvency II when using an approved internal model insurers are required to monitor the ongoing appropriateness of the internal model and its compliance with the tests and standards. Supervisory review process is required to evaluate this ongoing compliance.

**Topic 5: Valuation**

Under the state-based regime in the U.S., regulatory reporting is based upon Statutory Accounting Principles (SAP). While SAP is based on U.S. GAAP, SAP rejects or modifies GAAP in certain areas. Therefore, SAP financial statements are not fully consistent with GAAP financial statements. SAP financial statements are generally viewed as more conservative than GAAP financial statements. Whereas GAAP values assets and liabilities on a "going-concern" basis, SAP considers what assets would be available to pay claims akin to the company winding down as of the reporting date. Under SAP, certain assets that are illiquid and which are not readily available to pay claims are not admitted, have limited admissibility, or require immediate expensing to operations (*e.g.* deferred acquisition costs). Given that, SAP generally has less potential balance sheet variation than GAAP from year to year.[34] Instead of defaulting to fair or market values for financial assets (most notably debt investments), this regime bases investment valuation and RBC requirements on NAIC quality designations (1-6) that can result in different reporting (amortized value vs. market value for lower quality designations), with common stock reported at market value. Another example is that SAP requires all leases to be accounted for as operating leases and not capitalized (*i.e.* the lease is not recognized as an asset on the balance sheet).

In the EU, the solvency assessment of a company is based on an economic balance sheet. This provides an economic, risk-based view of the actual solvency condition of a firm at a given point in time. Assets and liabilities other than technical provisions are valued at fair value in conformity with IFRS, notwithstanding some prudential exemptions (*e.g.* goodwill) and specific conditions (e.g. intangible assets). Thus, the balance sheet used for solvency

[34] Life insurers in the U.S., for example, are required to have an asset valuation reserve (AVR) that provides conservatism and counter-cyclicality by setting up a reserve for market value fluctuations where assets are valued at amortized cost.

purpose in the E.U. is not fully consistent with IFRS financial statements. Given its use of market-consistent valuation, regulatory reporting in the EU is subject to greater potential balance sheet variation from year to year than is SAP, which is akin to a winding-up approach.

*Key Commonalities:*

- Both regimes consider the interaction between the valuation and the capital requirement.
- Both deviate from the accounting treatment in relation to the following:
    - Deferred Tax Asset treatment (under SAP, there are limits on admissibility, whereas in the EU an adjustment to available capital (own funds) is made for any net DTA);
    - Certain intangible assets are not allowed to be recognized as assets under RBC and are valued at zero under Solvency II; and
    - Deferred Acquisition Costs (DAC) are not allowed to be recognized as assets.

*Key Differences:*

- SAP considers what assets would be available to pay claims akin to the company winding down as of the reporting date; Solvency II constructs a market-consistent balance sheet, thereby facilitating supervision of firms as going concerns.
- Under the state-based regime in the U.S., the investment valuation and RBC requirements are tied to NAIC quality designations (1-6) and underlying characteristics. Investment valuation under Solvency II is based on fair/economic value, which implicitly reflects the quality designation;
- Some expected profit in future premiums are allowed, to the extent that future premiums on written contracts reduce technical provisions, under Solvency II, but not under RBC;
- Goodwill is allowed to be recognized under SAP as an asset up to an aggregate limit of 10% of the insurer's adjusted capital and surplus (reduced for goodwill, electronic data processing equipment and operating software, and net DTAs); Solvency II does not allow recognition of any goodwill.

**Topic 6: Calculation of Technical Provisions**

Under the state-based regime in the U.S., different approaches are taken with respect to the calculation of reserves for life insurance and for property & casualty insurance.

The calculation of reserves for life insurance policies generally is based on a formula prescribed in the Standard Valuation Law. That formula utilizes valuation mortality tables and valuation interest rates (a single discount rate based on a weighted average formula using

Moody's corporate bond yields for each calendar year of issue). State law requires the formula reserves to be tested for adequacy in aggregate through the use of an asset adequacy analysis to be performed annually by each company. For variable annuity products with guaranteed death and living benefit guarantees, the use of modeling is allowed with prescribed regulatory minimum floor reserves. Through the anticipated application of principles-based reserving, there will be increased use of modeling for life insurance products with guarantees.

The calculation of reserves for property & casualty insurance policies is determined by the best estimate of ultimate losses and related expenses, with that best estimate based on historical data within actuarial range. Current inflation trends and economic factors are considered in the calculation, while discounting is restricted to defined lines of business and is subject to commissioner approval.

Under the EU's Solvency II, reserves are determined on a fair value/market consistent basis. Technical provisions comprise the sum of the best estimate and risk margin; where the best estimate represents the probability weighted average of all future cash-flows discounted using a risk free rate term structure. A risk margin – calculated on the assumption that the whole portfolio of insurance obligations of the company is taken over by another company – is added to the best estimate. The best estimate covers expected losses and the risk margin is the cost of capital to support product until liabilities are fully run-off.

For life insurance reserves, the discount rate used within the EU reserving basis is lower than that used within the US basis. The inclusion of the risk margin within the EU basis represents an addition to the technical provisions and has no equivalent under the U.S. basis. Both of these aspects would increase the level of reserve strength under the EU basis relative to that under the U.S. basis, all other aspects being equal.

By contrast within the U.S. basis the formula reserve uses a prescribed valuation mortality table that contains a prudent margin and therefore is not a best estimate assumption. The formula reserve assumes no lapses and is based on one of several net premium patterns[35]. These aspects would increase the level of reserve strength in the U.S. basis relative to that observed in the EU basis, all other aspects being equal. To assess the precise combined effects of the factors noted above, one would need to consider the impact on specific products separately. Once Principle Based Reserving (PBR)[36] is fully operational in the U.S., mortality, lapse and expense assumptions would move closer to a best estimate basis plus a

[35] 1. Based on the interest and mortality of the reserve
2. Level percentage of the guaranteed gross premiums or
3. Other patterns
- Net level premium reserves (NLP)
- Commissioners Reserve Valuation Method (CRVM) - This method modifies the first year net premium and has the reserve lower the first year as just a mortality amount then they increase the net premium % in subsequent years this is because of the high first year commission costs.
- CRVM graded to NLP - This is a blended rate that uses CRVM in the first years and grades to a net level premium method.

[36] PBR will take several years before it becomes effective. Once effective, it only applies to prospective business.

margin; it is expected that at this point the U.S. and EU bases will be more similar. It is important to note however, since PBR only applies to new business, it will only be some time after implementation that the new basis will become predominant within the reserving position for those firms writing substantial amounts of long term business.

For non-life insurance, the EU reserving basis allows discounting, contrasted with the U.S. reserving basis where discounting is restricted to a few lines of business and is subject to commissioner approval. The effect of discounting would reduce the technical provisions but this is offset by the inclusion of the risk margin in the EU basis. At a first order the net effect of these two aspects broadly offset each other with no significant change in technical provisions expected. The precise impact and hence an assessment of the relative strength of the EU and U.S. reserving bases will depend on the specific product under consideration and is a function of the time to run-off of liabilities, the amount of capital required to support the product during run-off and the risk free term structure at the point of valuation.

*Key Commonalities:*

- Both regimes segregate the technical provisions (*i.e.* reserves) from other liabilities.
- Both regimes rely on an overlay of a supervisory framework to some degree. Both regimes allow regulators to demand a different level of reserve.

*Key Differences:*

- The reserving bases are different and an assessment of the relative strength of the EU and U.S. bases will depend on the specific product under consideration.
    - For life insurance, the EU basis contains a lower discount rate than the U.S. basis and includes a risk margin which has no equivalent under the U.S. basis. Both of these aspects would increase the level of technical provisions under the EU basis, all other aspects being equal. By contrast the mortality, expense and lapse assumptions under the U.S. basis contain implicit margins; the formula reserve assumes no lapses and is based on one of several net premium patterns. These aspects would increase the level of technical provisions relative to the EU basis.
    - For non-life insurance, the EU basis allows discounting, the U.S. basis only allows discounting for certain limited lines and is subject to commissioner approval. At a first order the inclusion of the risk margin in the EU basis broadly offsets the impact of discounting, the precise impact will depend on the specific product and risk free term structure present at the time of valuation.

**Topic 7: Definition of Capital/Requirements for Capital Resources**

Under the state-based regime in the U.S., TAC is generally equal to the book value of surplus funds (*i.e.* statutory capital and surplus)[37] with applicable adjustments depending on type of insurance company.[38] As noted in the prior discussion on valuation, adjustments are made for non-admitted and limited admissibility assets, as well as expensing rather than capitalizing and amortizing of certain deferred assets (*e.g.* deferred acquisition costs) under SAP. During the wind-up of an insurance company, there is a legal basis for priority of distributions.

Solvency II in the EU has a total balance sheet approach that requires a consistent valuation of assets and liabilities for solvency purposes in accordance with the "fair value" principle. In accordance with that approach, Basic Own Funds (i.e. capital) are mainly comprised of the net asset value, with some allowance for hybrid and subordinated capital instruments. In addition to the Basic Own Funds, ancillary own funds (e.g. unpaid capital, guarantees, other legally binding commitments) can also be taken into account to absorb losses subject to prior supervisory approval. Capital is classified based on loss absorbency on both a going-concern and wind-up basis under a three-tier system (Tier 1 is the most loss-absorbent and Tier 3 is the least). Solvency II sets floors or caps on the use of certain capital instruments in meeting capital requirements (*e.g.* limits on the amount of hybrid and subordinated capital instruments that qualifies as Tier 1 capital). It also makes specific deductions from available capital.[39] Hybrid and subordinated capital instruments may be converted or written down under specified circumstances.

*Key Commonalities:*

- For the majority of institutions (joint stock companies), capital will consist primarily of ordinary share capital, share premium and retained earnings attributable to shareholders.
- Both regimes have methodologies for recognizing the capital resources of mutual organizations.

*Key Differences:*

- Solvency II includes a three-tier classification of capital and provides specific treatment for hybrid and subordinated capital instruments. To the extent that

[37] In the state-based regime in the U.S., SAP (specifically, SSAP 72), defines categories of statutory surplus. Surplus notes – subordinated debt-like instrument issued by insurance companies – are classified as capital and surplus under SAP and liabilities under GAAP.

[38] For example, for life insurance companies, TAC is roughly equal to statutory capital and surplus plus the AVR plus 50% of policyholder dividend liability.

[39] Items that might be fully or partially deducted from capital under certain circumstances include the following: ring-fenced funds (where capital or assets are set aside to only absorb losses for particular parts of a business); large holdings in financial and credit institutions; and net deferred tax assets.

instruments do not provide the best form of loss absorbency, they are restricted in counting towards covering capital requirements. RBC is based on accounting principles (SSAP 72) that define categories of statutory surplus.

- Under Solvency II, capital items must have explicit features related to the capital requirements in order to count as available capital (*e.g.* capital items must be free from mandatory fixed charges and can only contain limited incentives to redeem). RBC does not tie such features directly to the capital item.

**Topic 8: Restrictions for Investments**

Under the state-based regime in the U.S., a state must adopt an investment law in order to be accredited. There are two basic models: a defined limits version and a defined standards version (prudent person approach). Each state must adopt a substantially similar version of one of these (or some combination of the two). As such, there can be some variation in the application of these investment laws from state to state. Both models include requirements for a written investment policy and board oversight and internal control activities related to investments. For various life insurance products, specific asset and liability matching, asset adequacy analysis and cash flow scenario testing activities are required.

With respect to the use of derivatives, some states restrict derivatives use to hedging only. Written hedges are required to be covered[40], where the insurer holds the underlying instrument. Derivatives use plans are considered when performing oversight activity. The RBC regime allows credit for direct hedges only but does not exempt any hedging derivatives from charges in the capital requirement calculation. Custodial arrangement and disclosure requirements exist to ensure the availability of the assets.

The EU's Solvency II's investment restrictions are consistent with the prudent person principle. Although the Solvency II approach does not include quantitative investment limits and asset eligibility criteria, the company's investment policy is expected to implement the prudent person principle and companies are expected to properly diversify assets to avoid excessive reliance on specific type of asset, counterparty, geographical area and industry[41]. At the same time, the company must consider the risks included in complex products. Solvency II has the explicit requirement that assets that cover technical provisions be invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities; those assets must be invested in the best interest of policy holders and beneficiaries in a manner consistent with the disclosed policy objectives on the related insurance products.

Solvency II allows insurers to use derivatives only insofar as they contribute to a reduction of risks or facilitate efficient portfolio management. Derivatives will be exempted from a capital charge under the "spread risk" sub-module only to the extent that the derivatives are part of

[40] A requirement set forth by the NAIC Accounting Practices & Procedures Manual.
[41] To a certain extent, diversification coefficients in market risk modules are also an incentive to diversifying assets.

the company's risk-mitigation strategy and hedge an underlying instrument held by the company (with non-material basis risk on the hedge).

*Key Commonalities:*

- Both regimes have requirements with regard to investments that aim to ensure that investment portfolios are established and managed prudently. However, the two regimes achieve this objective in very different ways.

*Key Differences:*

- Under Solvency II, undertakings are required to invest assets consistent with prudent person principle and in a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole. State laws in the U.S. limit activities and/or require a prudent person approach to address these investment considerations.
- In the EU, assets covering the technical provisions must be invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities. Under the state-based regime in the U.S., life insurers are subject to asset and liability matching requirements to achieve this investment consideration.
- In the EU, those assets must be invested in the best interest of all policy holders and beneficiaries taking into account any disclosed policy objective. In addition, the location of those assets shall be such as to ensure their availability. The state-based regime in the U.S. has custodial arrangement and disclosure requirements to ensure the availability of the assets.
- Under RBC, the NAIC Accounting Practices and Procedures Manual identifies those assets defined as admitted and those defined as non-admitted. If an asset is not defined in the Manual, it defaults to non-admitted status. With some state specific variations, states generally rely more on restrictions and limitations. RBC credit is granted for direct hedges only, with hedge accounting looking at the underlying value of the hedged investment.
- Under the Solvency II regime, insurance and reinsurance undertakings shall only invest (under a prudent principle person principle) in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs. The RBC regime sets limits on assets and, in some states, a prudent person principle applies.

**Appendix A – comparison RBC and Solvency II standard formula by risk**

| Non-life risks | RBC | Solvency II standard formula |
|---|---|---|
| **Market risk** | | (the market risk module is identical for life and non-life) |
| **Interest rate**<br><br>Methodology | Not applicable | Scenario based approach-based on the higher of the loss of the basic own funds, given two pre-determined upwards and downward shocks to the term structure of interest rates. |
| **Equity**<br><br>Methodology | The factor for other unaffiliated common stock is based on studies that indicate a 10%-12% factor is needed to provide capital to cover approx. 95% of the greatest losses in common stock value over 1-year horizon. A higher factor of 15% in the formula reflects regulatory judgement applied to recognize the increased risk when testing a period in excess of one year. | A downward shock (which varies by type of equity) is applied. For Type 1 equities (i.e. equities listed in EEA or OECD), the charge is sum of 39% and a symmetric adjustment to cover the risk arising from changes in the level of equity prices. For Type 2 equities (i.e. unlisted or listed in non-EEA/non-OECD countries, private equities, hedge funds, commodities and other alternative investments), the charge is sum of 49% and a symmetric adjustment. For strategic participations the capital charge is 22%. |
| **Property**<br><br>Methodology | Two –part factor based approach-<br><br>1. The book/adjusted carrying value is multiplied by a factor.<br>2. Encumbrances requirement is multiplied by an encumbrance factor.<br><br>The total charge is (1) + (2). The factors are 10%<br><br>Schedule BA assets are assessed a 20% charge, | Scenario based approach-based on the loss of the basic own funds resulting from an instantaneous decrease of 25% in the value of the real estate |

| **Market risk (cont'd)** | | (the market risk module is identical for life and non-life) |
|---|---|---|
| **Spread**<br><br>Methodology | Factor-based approach, varying by asset type and credit rating / quality. All factors are applied, to statement values of the specific assets.<br><br>Bond factors are based on cash flow modelling using historically adjusted default rates for each bond category. A size factor reflects additional modelling for different size portfolios to reflect that risk increases as the number of bond issuers decreases. | A factor based approach (based on duration and credit rating/quality of financial instruments) is used. The financial instruments are classified in to three categories, (1) Bonds and loans, (2) tradable securities or other financial instruments based on repackaged loans and (3) credit derivatives, in calculating the capital requirements. |
| **Concentration**<br><br>Methodology | Factor based approach. The concentration factor doubles the RBC factor up to a maximum of 15% of the 10 largest asset exposures. | The concentration risk is calculated on the basis of single names exposures. The capital charge is calculated based on exposure exceeding certain thresholds, which depends on the credit quality of the exposures. |
| **Currency**<br><br>Methodology | Not applicable | Based on the higher of the capital requirements resulting from a 25% instantaneous increase in the value of foreign currency against the local currency and a 25% instantaneous decrease in the value of foreign currency against the local currency. |
| **Counterparty default risk** | | |
| Methodology | Factor based approach is applied to two categories<br><br>1. Credit Risk-reinsurance- 10% of ceded balances for claims reserves and unearned premium. 10% is judgement factor reflecting various elements of reinsurance risk.<br>2. Credit Risk-Other than reinsurance: Judgement values, @ 5% for most receivables, 1% for investment income due and accrued, and no charge for agents' balances, which are subject to statutory accounting valuation rules. | The Approach is applied to two categories:<br><br>1. A factor based approach using a combination of probability of default (based on Credit quality) and loss given default for risk-mitigation contracts, cash and commitment received covering a small (less than 15) single names exposures; and<br>2. A scenario based approach for other (more diversified) counterparty default exposures. |

| | | |
|---|---|---|
| **Non-Life Underwriting Risk** | | |
| **Non-Life premium and reserve**<br><br>Methodology | Factor based approach applied in 3 parts:<br>1. Written premiums – factors developed by line of business using historical industry combined ratio data discounted at 5% per year. .<br>2. Reserves - factors developed by line of business based discounted (5%per year) industry-wide reserve development patterns averaged over a 9 year period and compared to company specific development patterns.<br>3. A premium concentration factor is applied if to address cases where a large proportion of premium is written in a single line of business,<br>There is also an "Excessive Premium Growth provision that includes a charge for rapidly growing premium volume. | Factor based approach:<br>1. Premium and Reserves, 3 times the volatility for each line of business is applied. Specific standard deviations for each segment of business are applied separately for premium and reserves, and correlation factors are applied between segments of business.<br>2. Lapse risk: a scenario based approach is used. |
| **Non-life catastrophe**<br><br>Methodology | Implicit in net premium risk charges (Data being collected beginning in 2012 to establish a risk charge for property catastrophe risk. Target date for implementation is 12/31/13.) | Factor based approach or Scenario based depending on the underlying risk for several sub-modules covering natural catastrophe, man-made catastrophe and other types of non-life catastrophe. |
| **Operational risk** | | |
| Methodology | Not applicable | Factor based approach, based on the sum of the lower of 30% of the basic SCR and a proportion of earned premiums or technical provisions, plus 25% of expenses incurred during the last 12 months in respect of life contracts where the investment risk is borne by policyholders. |

Non-life lapse and Intangible Asset risk are not captured in RBC so these risk modules have not been included in this table. All Solvency II calibrations are based on a 99.5% Value at Risk over one year horizon, where as there is no specific risk measure and time horizon for RBC overall.

| Life risks | RBC | Solvency II Standard formula |
|---|---|---|
| **Market risk** | | (the market risk module is identical for life and non-life) |
| **Interest rate**<br><br>Methodology | In the factor based approach, the factors represent the surplus necessary to provide for a lack of synchronisation of asset and liability cash flows and the risk categories vary by withdrawal provision Companies must submit an unqualified actuarial opinion based on asset adequacy testing to be eligible for a credit of one-third of the RBC otherwise needed.<br><br>A cash flow testing technique may be used/required for part of the RBC on Certain Annuities and Single Premium Life Insurance. | Scenario based approach, based on the higher of the loss of the basic own funds, given two pre-determined upwards and downward shocks to the term structure of interest rates. |
| **Equity**<br><br>Methodology | For unaffiliated common stock, a 30% pre-tax factor is needed to cover 71approx. 95% of the greatest losses in common stock over a 2 year period and adjustments are made to account for differences between the insurer's portfolio and the Standard and Poor's 500.<br><br>For affiliated common stock it is 'calculated on a "see through" basis (multiplied by the percentage ownership). The pre-tax factor for common stock of other affiliates is set at 30 percent since many of these investments have risk characteristics similar to those of unaffiliated common stock.<br><br>A sensitivity analysis is completed using a factor of 100 percent due to management's knowledge and control of the affiliate. | A downward shock (which varies by type of equity) is applied. For Type 1 equities (i.e. equities listed in EEA or OECD), the charge is sum of 39% and a symmetric adjustment to cover the risk arising from changes in the level of equity prices. For Type 2 equities (i.e. unlisted or listed in non-EEA/non-OECD countries, private equities, hedge funds, commodities and other alternative investments), the charge is sum of 49% and a symmetric adjustment. For strategic participations the capital charge is 22% |

| **Market risk** | | (the market risk module is identical for life and non-life) |
|---|---|---|
| **Property**<br>Methodology | A factor based approach is used: (1) a 15% pre-tax factor for company owned real estate, (2) 23% for foreclosed real estate and (3) 23% for Schedule BA real estate because of the additional risks inherent in owning real estate through a partnership. | Scenario based approach-based on the loss of the basic own funds resulting from an instantaneous decrease of 25% in the value of the real estate. |
| **Spread**<br>Methodology | ***Bonds and unaffiliated Preferred stock***<br>RBC charges are determined by applying a set of factors, varying by asset type and credit quality, to statement values of those assets. The bond factors are based on cash flow modelling over a 10 year time horizon using historically adjusted default rates for each bond category. The factors chosen for the proposed formula produce a level of surplus at least as much as needed in 92% of the trials by category and a 96% level for the entire bond portfolio. | A factor based approach (based on duration and credit rating/quality of financial instruments) is used. The financial instruments are classified in to three categories, (1) Bonds and loans, (2) tradable securities or other financial instruments based on repackaged loans and (3) credit derivatives, in calculating the capital requirements. |
| **Concentration**<br>Methodology | The asset concentration factor doubles the RBC factor up to a maximum of 45% of the 10 largest asset exposures. In addition, there is also a common stock concentration factor to reflect the additional risk of high concentrations in a single exposure of common stock. The common stock concentration factor increases by 50% the RBC factor for the five largest common stock exposures. | The concentration risk is calculated on the basis of single names exposures. The capital charge is calculated based on exposure exceeding certain thresholds, which depends on the credit quality of the exposures. |
| **Currency**<br><br>Methodology | Not applicable | Based on the higher of the capital requirements resulting from a 25% instantaneous increase in the value of foreign currency against the local currency and a 25% instantaneous decrease in the value of foreign currency against the local currency. |

| **Counterparty default risk** | | |
|---|---|---|
| Methodology | ***Mortgages***<br><br>Mortgages-Factors were derived from the results of a model developed by Walter C. Barnes and S. Michael Giliberto that relates the probability of loss on an impaired mortgage to its contemporaneous loan-to-value ratio. The factor also recognizes delinquency data from the Society of Actuaries "Commercial Mortgage Credit Risk Study."<br><br>***Reinsurance***<br><br>There is a risk associated with the recoverability of amounts from reinsurers. This is deemed comparable to that represented by bonds between risk classes 1 and 2 and is assigned a pre-tax factor of 0.8 percent.<br><br>***Derivative Potential Exposure***<br><br>The calculation of the risk of potential exposure is based on research supporting the Bank of International Settlements framework for banks. The off-balance sheet exposure as reported will measure this potential exposure for RBC purposes. The factors applied to the derivatives off-balance sheet exposure are the same as those applied to bonds. | The Approach is applied to two categories:<br><br>1. A factor based approach using a combination of probability of default (based on Credit rating) and loss given default for risk-mitigation contracts, cash and commitment received covering a small (less than 15) single names exposures (Type 1 exposures); and<br>2. A scenario based approach for other type of counterparty default exposures (Type 2 exposures). |

| **Life Underwriting risk** | | |
|---|---|---|
| **Mortality** | | |
| Methodology | In RBC, there are no explicit mortality or longevity risk charges but there is a Life insurance risk. The factors chosen represent surplus needed to provide for excess claims over expected, both from random fluctuations and from inaccurate pricing for future levels of claims. For a large number of trials, each insured either lives or dies based on a "roll of the dice" reflecting the probability of death from both normal and excess claims. The present value of the claims generated by this process, less expected claims, will be the amount of surplus needed under that trial. The factors chosen under the formula produce a level of surplus at least as much as needed in 95 percent of the trials. | In Solvency II, the Life Underwriting risk module covers the following risks: Mortality, Longevity, Disability-morbidity, Life Expense, Revision, Lapse and Life catastrophe risk.<br><br>Mortality risk: The capital requirement is the loss in basic own funds that would result from an instantaneous permanent increase of 15% in the mortality rates used for the calculation of technical provisions.<br><br>Longevity risk: The capital requirement is the loss in basic own funds that would result from an instantaneous permanent decrease of 20% in the mortality rates used for the calculation of technical provisions. |
| **Operational risk** | | |
| Methodology | In RBC, there is no operational risk requirement but there are Business risks which are to a certain extent similar. For life and annuity business, the RBC pre-tax contribution is 3.08 percent of Schedule T life premiums and annuity considerations before taxes. A smaller pre-tax factor of 0.77 percent is applied against Schedule T accident and health premiums. The smaller factor for accident and health business recognizes that general business risk exposure is, in part, a function of reserves. | Factor based approach, based on the sum of the lower of 30% of the basic SCR and a proportion of earned premiums or technical provisions, plus 25% of expenses incurred during the last 12 months in respect of life contracts where the investment risk is borne by policyholders. |

Disability-morbidity, Life expense, Revision, Lapse, Life Catastrophe and Intangible Asset risks are not captured in RBC so these risk modules have not been included in this table. All Solvency II calibrations are based on a 99.5% Value at Risk over one year horizon, where as there is no specific risk measure and time horizon for RBC overall.

Please note that Appendix A of TC3 (pages 68 - 74) does not purport to represent or pre-judge the views and/or the formal proposals of the EC. The approach described in the table is still under development, however, largely based on what was tested in the last full quantitative impact study (QIS5), the technical specifications for which are publicly available.

## 4. Reinsurance and Collateral Requirements

**Executive summary:** TC4 covers the key commonalities and differences that exist between both regimes in relation to the supervisory requirements for reinsurance and collateral. The main topics analyzed include the policy objectives, risk transfer requirements, credit for reinsurance and collateral requirements, capital requirements and consistency. A number of additional topics, including requirements relating to affiliated reinsurance transactions, concentration risk, securitization, reporting and U.S. market statistics are also considered.

Several commonalities between the two regimes can be observed in terms of the overall policy objectives and the risk transfer requirements. Both regimes seek to ensure the ongoing solvency of domestic insurance and reinsurance companies in order to protect policyholders. Under both regimes, risk mitigation techniques must fulfill criteria relating to genuine and effective risk transfer in order to receive credit, although some differences between the two regimes do exist. Each also requires that ceding companies reflect the counterparty default risk associated with reinsurance in their capital requirements, although this is done in different ways.

Both have specific requirements for reinsurance ceded by domestic insurers to foreign reinsurers and have recently established frameworks for reviewing the reinsurance solvency and supervisory regimes of other jurisdictions. However, there are key differences between the two regimes with respect to the requirements for recognition of reinsurance ceded to foreign reinsurers, and the frameworks for reviewing the regulatory regimes of foreign jurisdictions are different. In the EU, Member States are prohibited from requiring collateral in relation to reinsurance arrangements entered into with companies situated in equivalent third countries (reinsurance arrangements with these companies would be treated in the same manner as reinsurance arrangements concluded with EU reinsurers). Under the state-based regime in the U.S., the 2011 amendments to the NAIC Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) (NAIC Credit for Reinsurance Models) serve to reduce the prior reinsurance collateral requirements for non-U.S. licensed reinsurers that are licensed and domiciled in qualified jurisdictions, and those reinsurers will be required to post collateral according to their assigned rating. In the EU, decisions on third country equivalence in relation to reinsurance are effective across the EU and cannot be overridden by Member States, while in the U.S., collateral reduction is optional on the part of the states.

### Topic 1: Policy Objectives

*Overall Policy Framework & Supervisory Regime*

*Key Commonalities*

In both regimes, the solvency regime applied to reinsurance companies largely mirrors the solvency regime applied to direct (primary) insurers. Also, both regimes seek to ensure the

ongoing solvency of domestic insurance and reinsurance companies in order to protect policyholders.

*Key Differences*

In the EU, reinsurance undertakings (defined as legal entities authorized to pursue reinsurance activities) are required to limit their objects to the business of reinsurance and related operations, although direct insurers may also be authorized to write reinsurance business. U.S. reinsurers are generally permitted to write insurance business on a direct or assumed basis.

*Insolvency Proceedings*

*Key Commonalities*

In the state-based regime in the U.S. and in several EU Member States, reinsurance claims are subordinated to policyholders (direct insurance claims).[42]

Certain jurisdictions within the U.S. (Rhode Island) and within the EU (the UK and Ireland) have a concept of Solvent Schemes of Arrangement, which allows a company and its creditors to agree on a value of the creditors' current and future liabilities as a basis for negotiating a settlement or commutation. Other EU Member States have similar, but non-statutory, commutation schemes, which are also aimed at avoiding near-to-insolvency situations.

Although not all U.S. states maintain identical receivership statutes, the NAIC's Accreditation Program (see TC6 report) provides that state law shall set forth a receivership scheme for the administration of insurance companies found to be insolvent that is substantially similar to that set forth in the NAIC's Insurer Receivership Model Act (#555). In the EU, the law that applies when a reinsurer is wound up or becomes insolvent is a Member State competence. Similarly, the law that applies when an insurer is wound up or becomes insolvent is largely left to Member State competence.

**Topic 2: Risk Transfer Requirements**

*Key Commonalities*

Under both regimes, risk mitigation techniques must fulfill criteria relating to genuine and effective risk transfer in order to receive credit, however the specific criteria differs.

[42] The UK, Italy and the Netherlands are examples of Member States where reinsurance claims are subordinated to the claims of policyholders. Germany is an example of a Member State where the prior rank of claims of policyholders depends on certain conditions so that reinsurance claims are not automatically subordinated to the claims of policyholders and may in some cases share the same ranking.

*Key Differences*

Under the state-based regime in the U.S., contractual features of the reinsurance arrangement must not prevent timely reimbursement. Reinsurers must undertake to indemnify the ceding entity against loss or liability by reason of the original insurance, such that the reinsurer assumes significant insurance risk and it is reasonably possible that the reinsurer may realize a significant loss. With respect to the property and casualty business under the state-based regime in the U.S., credit for reinsurance is not allowed unless the agreement contains the essential element of transfer of insurance risk (both underwriting risk and timing risk). With respect to life business, it is required that reinsurance agreements transfer all of the significant risks inherent in the business being reinsured in order to receive reinsurance accounting treatment.

Under the EU regime, there must be effective transfer of risk and the extent of cover and transfer of risk must be clearly defined and incontrovertible. A contractual arrangement must not be subject to any conditions which could undermine the effective transfer of risk. Reinsurance arrangements must be legally effective and enforceable and the undertaking must have a direct claim on the counterparty in the event of a default, insolvency or bankruptcy of a counterparty or other credit event.

**Topic 3: Credit for Reinsurance & Collateral Requirements**

*Credit for reinsurance*

*Key Commonalities*

Both regimes give credit for the transfer of risk to reinsurers, subject to certain conditions. Partial credit may also be given where conditions are largely, but not fully, met. The credit for the transfer of risk to reinsurers is reflected in the recording of recoverable assets or reduced insurance liabilities (technical provisions in the EU).

*Key Differences*

A U.S. ceding company is only allowed to take statutory credit for reinsurance ceded to an assuming reinsurer meeting one of the following requirements:

- The reinsurer is licensed in the same state of domicile as the ceding company for a like kind of business.
- The domiciliary insurance department of the ceding company accredits the reinsurer.
- The reinsurer is domiciled and licensed in a state with substantially similar credit for reinsurance laws as the state of the ceding company.
- The reinsurer provides collateral in the form of a multiple beneficiary trust.

- The reinsurer is certified and approved for collateral reduction by the domestic state of the ceding insurer.

- The reinsurer provides collateral or other security to the ceding insurer.

In the EU, credit for reinsurance is expected to be contingent on the reinsurer being either:

- An EU company which complies with the SCR;

- A third-country company situated in a third country whose solvency regime for reinsurance activities is equivalent to Solvency II and which complies with the solvency requirements of that third-country; or

- A third country insurance or reinsurance undertaking situated in a third country that is not equivalent and which is rated at least investment grade quality[43].

*Collateral*

*Key Commonalities*

While the conditions relating to the recognition of reinsurance credit by a cedent are different under the two regimes, both have specific requirements for reinsurance ceded by domestic insurers to foreign reinsurers. Under both regimes, credit for reinsurance ceded to an assuming insurer domiciled in the same jurisdiction (U.S. state/EU Member State) as the ceding insurer may be taken without collateral or other security being posted by the reinsurer. Both Solvency II and the 2011 revisions to the NAIC Credit for Reinsurance Models have established frameworks for reviewing the reinsurance solvency and supervisory regimes of other jurisdictions.

*Key Differences*

The EU's regime distinguishes between reinsurance arrangements entered into with undertakings with their head office in a third country whose solvency regime is equivalent to Solvency II and undertakings situated in other third countries. The criteria for determining the equivalence of a third country's solvency or prudential regime[44] are intended to ensure that the third country reinsurer is subject to solvency requirements equivalent to those imposed on EU reinsurers.

In the EU, for reinsurers domiciled in non-EU jurisdictions that are considered equivalent, the reinsurance arrangement would be treated in the same manner as reinsurers concluded with EU reinsurers (not more favorably). Member States are prohibited from requiring collateral in relation to reinsurance arrangements entered into with companies situated in equivalent third

[43] The measures that will implement Solvency II are likely to introduce the concept of credit quality steps, with the lowest investment grade being equivalent to credit quality step 3.
[44] Referred to throughout as "third country equivalence."

countries. With respect to jurisdictions which have not been found to be equivalent, Solvency II leaves the option of imposing collateral requirements to the Member State; however, if the reinsurance arrangement is with a third country undertaking in a regime which is not equivalent and the reinsurer has a credit rating lower than investment grade, it is expected that Solvency II will require collateral to be held by a deposit taking institution rated at least investment grade if the insurer wishes to take credit for the arrangement.

Those Member States which currently impose collateral requirements in relation to reinsurance arrangements entered into with third country undertakings may continue to do so under Solvency II in relation to undertakings situated in third countries that are not considered to be equivalent. The Member States that currently impose collateral include France and Portugal.

Under the state-based regime in the U.S., the 2011 amendments to the NAIC Credit for Reinsurance Models serve to reduce the prior reinsurance collateral requirements for non-U.S. licensed reinsurers that are licensed and domiciled in qualified jurisdictions. Previously, in order for U.S. ceding companies to receive reinsurance credit, the reinsurance was required to be ceded to U.S. licensed reinsurers or secured by collateral representing 100% of U.S. liabilities for which the credit is recorded. The model revisions establish a certification process for reinsurers under which a certified reinsurer is eligible for collateral reduction with respect to contracts entered into or renewed subsequent to certification. Each state will have the authority to certify reinsurers or to recognize the certification issued by another NAIC-accredited state.

The 2011 revised NAIC Credit for Reinsurance Models introduce the concept of qualified jurisdictions, as well as the financial strength and business practices of the reinsurer, in determining collateral requirements. A certified reinsurer must be domiciled and licensed in a qualified jurisdiction in order to be eligible for collateral reduction. The process for determining qualified jurisdictions is still being developed.

The proposed revisions to the key elements of the reinsurance ceded accreditation standard with respect to collateral reduction are an optional standard on the part of the states. In other words, states can maintain the 100% collateral requirement on non-U.S. licensed reinsurers and remain accredited. If a state enacts reinsurance collateral reduction measures, those measures would be required to be substantially similar (i.e. similar in force and no less effective) to the key elements of the NAIC models. With respect to jurisdictions which have not been found to be qualified, the revised NAIC models would require 100% collateral to be posted. With respect to jurisdictions deemed qualified, the revised NAIC models would allow states to require 100% collateral or reduced collateral requirements based upon a rating of that reinsurer.

Currently, eleven states have enacted reduced collateral provisions (Florida, New York, New Jersey, Indiana, Virginia, Connecticut, California, Louisiana, Pennsylvania,Georgia and Delaware), with other states currently considering proposals.

The Dodd-Frank Act also authorizes the Secretary of the Treasury and the U.S. Trade Representative jointly to negotiate and enter into bilateral or multilateral agreements regarding prudential matters with respect to the business of insurance or reinsurance. FIO will assist the Secretary with those responsibilities.

The following is a comparison of several key elements of the revised models (to include the optional collateral reduction provisions) with the requirements under Solvency II:

- Under the state-based regime in the U.S., each state may evaluate a non-U.S. jurisdiction in order to determine if it is a "qualified jurisdiction." A list of qualified jurisdictions will be published through the NAIC Committee Process, which is currently under development by the NAIC. A state must consider this list in its determination of qualified jurisdictions, and if the state approves a jurisdiction not on this list, the state must thoroughly document the justifications for approving this jurisdiction in accordance with the standards for approving qualified jurisdictions contained in the model regulation. In the EU, decisions on third country equivalence in relation to reinsurance would be taken by the European Commission (EC), not by Member States. Those decisions are effective across the EU, i.e. a Member State cannot override the legal consequences of an equivalence decision at national level.

- Under the state-based regime in the U.S., the criteria for determining whether a jurisdiction is qualified are based on the appropriateness and effectiveness of the reinsurance supervisory regime of the jurisdiction and the extent of reciprocal recognition by the non-U.S. jurisdiction. The issue of how appropriateness and effectiveness will be judged is still in a state of development, but is likely to be qualitative. In the EU, the criteria for determining the equivalence of a third country's solvency or prudential regime are based on the high-level principles set out in the Solvency II Directive.

- Under the state-based regime in the U.S., a certified reinsurer will be eligible for collateral reduction with respect to contracts entered into or renewed subsequent to certification. A state will evaluate a reinsurer that applies for certification, and will assign a rating based on the evaluation. Evaluation criteria include, but are not limited to, financial strength, timely claims payment history, and the requirement that a reinsurer be domiciled and licensed in a "qualified jurisdiction." A certified reinsurer will be required to post collateral in an amount that corresponds with its assigned rating in order for a U.S. ceding insurer to be allowed full credit for the reinsurance ceded. Financial strength ratings[45] are one factor a state will use to evaluate a reinsurer and assign a rating which establishes the collateral requirement applicable to the reinsurer (Secure-1 = 0%, Secure -2 = 10%, Secure 3 = 20%, Secure-4 = 50%, Secure-5 = 75%, Vulnerable-6 = 100%). The lowest financial strength rating from an approved rating agency establishes a maximum rating that can be assigned by the state (i.e. it establishes the maximum amount of collateral reduction allowed for the

[45] Under the revised NAIC models, in order to be eligible for certification, a reinsurer is required to maintain at least two financial strength ratings from approved rating agencies.

reinsurer).[46] Factors beyond the financial strength rating may be used to support an increase in the reinsurer's collateral requirement but can never be used to support a further reduction in the collateral requirement. An upgrade in the certified reinsurer's assigned rating applies on a prospective basis, while a downgrade applies to all business entered into as a certified reinsurer. The EU ban on collateral for equivalent third countries is not discretionary. The EU does not link the ban on collateral in equivalent third countries to the rating of companies in those countries. The EU's ban on the imposition of collateral for reinsurance arrangements with undertakings in equivalent third countries applies to all current and existing contracts.[47]

- Under the state-based regime in the U.S., financial statements are one of the criteria used by the commissioner in determining a certified reinsurer's rating/collateral requirement. Certified reinsurers from qualified jurisdictions must reconcile their financial statements prepared on the basis of International Financial Reporting Standards to U.S. Generally Accepted Accounting Principles and must meet ongoing filing requirements. There are no similar requirements imposed on reinsurers from equivalent third countries in the EU.

- Under the state-based regime in the U.S., reinsurance contracts entered into or renewed with a certified reinsurer shall include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer under this section for reinsurance ceded to the certified reinsurer.[48] The EU's regime does not have a concept of a funding clause. However, all EU reinsurers must hold capital to meet their MCR and their SCR.

**Topic 4: Capital Requirements**

*Key Commonalities*

Under both regimes, insurers ceding reinsurance must reflect the counterparty default risk associated with reinsurance counterparties in their capital requirements.

*Key Differences*

The state-based regime in the U.S. generally applies a fixed RBC charge for the recoverable depending on the line of business. Hence, RBC reflects the credit risk associated with the recoverables from the reinsurer through the use of fixed parameters per line of business. These factors vary by sector (*e.g.*, life, P&C and health), but do not currently capture the

[46] The model regulation indicates how the lowest financial strength rating from a rating agency corresponds to an applicable rating in the aforementioned rating scale.
[47] Note that the impact of collateral arrangements that have been entered into for commercial reasons on capital requirements for EU ceding insurers is discussed under Topic 4.
[48] Under the state-based regime in the U.S., additional terms are required for reinsurance agreements in general, for example an insolvency clause and a reinsurance intermediary clause when applicable.

credit risk specific to the counterparty or the reinsurance arrangement, nor collateral arrangements entered into for commercial reasons. However, the NAIC is currently considering refinement to the credit risk charge for reinsurance recoverables. Statutory accounting guidance requires an assessment of the collectability of reinsurance recoverables, provides for a minimum reserve for uncollectible reinsurance with an additional reserve required if an insurer's experience indicates that a higher amount should be provided and does not allow credit for amounts determined to be uncollectible.

The approach envisaged under the EU regime is based upon the probability of default and the loss given default of the counterparty. Where collateral arrangements have been entered into for commercial reasons, the loss given default in the calculation of counterparty default risk is lower.[49]

In the state-based regime in the U.S., RBC uses premium, claim and reserve amounts on a net of reinsurance basis. This is also the case for the EU with respect to the factor based, SCR standard formula calculations. The scenario based capital calculations in the EU's SCR standard formula take into account the impact of risk mitigation techniques, including reinsurance, by looking at the change in value of assets and liabilities in different scenarios.

In addition to capital requirements on counterparty default risk, the EU requires amounts recoverable from reinsurance and SPVs to be adjusted for the expected losses due to counterparty default in the technical provisions calculation.

**Topic 5: Consistency**

*Key Commonalities*

Both regimes issue guidelines and standards with the aim of fostering supervisory convergence and uniformity amongst U.S. states and Member States respectively in the area of reinsurance regulation, including credit for reinsurance and collateral.

*Key Differences*

The NAIC Accreditation Program, which is further explained in TC6, provides financial regulation standards that apply to the regulation of insurers and reinsurers, including a

[49] The formula for counterparty default risk and its components will be set out in the measures that will implement Solvency II and is therefore subject to change. As noted, the determination of counterparty default risk is based upon the probability of default and the loss given default of the counterparty. The probability of default is likely to be determined either by reference to the credit rating of the counterparty or where this credit rating is not available and the counterparty is an EU insurance or reinsurance undertaking based on its solvency ratio. For counterparties that are insurance or reinsurance undertakings in equivalent third countries, compliance with the solvency ratio can be used where a credit rating is not available. In this case, it is likely that the probability of default where the third country insurance or reinsurance undertaking meets the third country's solvency requirement will be the same as for EU undertakings with a 100% solvency ratio. It is currently envisaged that loss given default will be a function of the best estimate of the recoverable amount from the reinsurance arrangement and the risk mitigating effect on the underwriting risk of the reinsurance arrangement minus the risk-adjusted value of the collateral that would be available under the reinsurance arrangement.

specific standard with respect to reinsurance ceded. The Reinsurance Ceded Accreditation Standard requires that state law should contain the NAIC Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) and the NAIC Life and Health Reinsurance Agreements Model Regulation (#791), or substantially similar laws. The NAIC's Accreditation Program, while voluntary in nature, establishes baseline standards for insurance company financial solvency regulation by the states. A state's ability to enact solvency regulation that is more effective than the standard is preserved.

The proposed revisions to the key elements of the reinsurance ceded accreditation standard with respect to collateral reduction are an optional standard on the part of the states; however, any reinsurance collateral reduction legislation enacted by a state would be required to be substantially similar to the key elements of the NAIC models in order for a state to remain accredited. To date, eleven states have implemented reinsurance collateral reduction under their laws, although other states are currently in the process of implementing these revisions.

In the EU, Solvency II will greatly reduce any differences in the laws/regulations and practices of Member States that exist under Solvency I and which were evidenced in the Committee of European Insurance and Occupational Pensions Supervisors' (CEIOPS) survey carried out in 2009[50]. This is because the requirements relating to credit for reinsurance and collateral explicitly restrict the actions of Member States in certain cases and are set out in European law. The CEIOPS survey provides some indication of the additional requirements that Member States may continue to impose in relation to reinsurance arrangements with companies in third countries whose regime is not equivalent.

A consistent and harmonized approach among European supervisory authorities will also be ensured by technical standards and guidelines which EIOPA is currently developing.

## Topic 6: Other

6.1 Affiliated Reinsurance Transactions and Concentration Risk

*Key Commonalities*

Neither regime provides explicit limits on the amount of reinsurance that can be ceded to a specific reinsurer or group of related reinsurers.

*Key Differences*

[50] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/CEIOPS-ConCo-05-09-report-questionnaire-treatment-of-3rd-countries-reinsurers.pdf

In the U.S., companies must obtain prior supervisory approval before entering into pooling arrangements or any material reinsurance transaction with an affiliated party. The IHC Model Act, which applies directly to insurers and indirectly to non-insurance holding companies, allows states to regulate transactions between insurers and other affiliated entities. The model includes provisions relating to reinsurance between affiliated companies with common ownership or control. There are no special requirements for affiliated reinsurance in the EU. In the EU, the effects of intra-group reinsurance are eliminated for group solvency purposes (see report of TC2). EIOPA is drafting guidelines on the recognition of pooling arrangements, but these are not expected to propose different treatments for affiliated and non-affiliated parties.

The NAIC recently adopted new notification requirements applicable to ceding insurers with respect to concentration risk of reinsurance ceded (concentration risk at the group level is also discussed in the report of TC2). Under the proposed accreditation standard, the concentration risk notification requirements are applicable to reinsurance ceded to both U.S. and non-U.S. reinsurers; however, they would only be required to be enacted by those states that are implementing reduced collateral requirements. U.S. state regulators have additional authority through state laws which are substantially similar to the NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385) and to the IHC Model Act (with respect to affiliated transactions). There is not an RBC charge related to reinsurance concentration risk. In the EU, all companies must hold capital against concentration risk. The EU's requirements on concentration risk are not linked to the imposition of collateral.

6.2 Reinsurance Securitization

*Key Commonalities*

Under both regimes, credit for reinsurance may be allowed for transfer of risk through insurance securitizations, when certain conditions are met. The EU regime gives credit for effective risk transfer to SPVs. The EU regime is expected via implementing measures to require SPVs to be bankruptcy remote, i.e. effective arrangements exist which ensure that the assets of the SPV are at all times protected from the insolvency proceedings of associated undertakings. In the U.S., securitizations using protected cells must isolate assets and liabilities related to an insurance securitization, and are protected from the insolvency of the rest of the insurer. The NAIC's Special Purpose Reinsurance Vehicles Model Act (#789) (SPRV Model Act) requires SPRVs to be fully funded, and provides that the SPRV may not be controlled by, may not control, or may not be under common control with, any ceding insurer that is a party to an SPRV contract. Under both regimes the assets of the SPV/SPRV are valued at market/fair value.

The EU requires Member States to make the establishment of SPVs in their territories subject to authorization. In the state-based regime in the U.S., SPRVs must obtain a certificate of authority, limited to the purpose of entering into insurance securitization transactions under a

SPRV contract. The NAIC has taken measures to actively promote the use of SPRVs established onshore, including exemptions from insurance laws, within limitations, though the SPRV Model Act is not widely adopted by the states and is not required to be enacted by the states under the NAIC Accreditation Program. The majority of SPVs created to securitize U.S. risk are formed offshore or onshore through state captive laws. The captive law in several states permits the creation of special purpose financial captives, which would enable captive insurance companies to facilitate risk securitization transactions in order to access additional sources of capital.

In both regimes, the SPV/SPRV requirements must be met for undertakings to take credit for the securitization.

*Key Differences*

The NAIC has taken measures to actively promote the use of SPRVs established onshore, including exemptions from insurance laws, within limitations, though the SPRV Model Act is not widely adopted by the states and is not required to be enacted by the states under the NAIC Accreditation Program. The majority of SPVs created to securitize U.S. risk are formed offshore or onshore through state captive laws. The captive law in several states permits the creation of special purpose financial captives, which would enable captive insurance companies to facilitate risk securitization transactions in order to access additional sources of capital. There is no analogous provision in the E.U.

6.3 Reporting

*Key Commonalities*

Both regimes provide for supervisory reporting, data collection and analysis, and disclosure requirements with respect to reinsurance assumed or ceded by domestic insurers. Both regimes require companies to report their solvency and financial condition to supervisors. Certain information must also be publicly disclosed. Supervisory reporting and public disclosure requirements include information relating to reinsurance arrangements, including reinsurance recoverables, receivables and payables.

*Key Differences*

While both regimes require disclosure of significant information with respect to reinsurance, the degree to which this information is available to the public varies. In the state-based regime in the U.S., public disclosure requirements include historical data and the level of detail disclosed is assumed to be higher. The EU is still in the process of developing its disclosure requirements. Solvency II requirements on reporting and public disclosure go in a similar direction to the U.S.; this is analyzed in more detail in the report of TC5.

6.4 Statistics

A significant portion of the risk ceded by U.S.-domiciled companies goes to reinsurers domiciled outside of the U.S. With respect to unaffiliated reinsurance market share, the Reinsurance Association of America indicated in its 2010 year-end data analysis *Offshore Reinsurance in the U.S. Market* that U.S.-domiciled professional reinsurance companies accounted for just over 40% of the premium assumed from U.S. ceding insurers, while alien or offshore companies accounted for just less than 60%. These statistics should be seen in the context of reinsurance business globally and the geographical diversification of risk. The total premium ceded to unaffiliated offshore reinsurers was $24.5 billion, with net recoverables of $36 billion. It should be noted that the data is derived from the Schedule F (property/casualty) of the annual statements of each company that are filed with the NAIC and excludes premiums ceded to non-reinsurance companies as well as to pools and associations.

## 5. Supervisory Reporting, Data Collection and Analysis and Disclosure

**Executive summary:** While there are differences in the means by which the EU regime and the state-based regime in the U.S. handle reporting, data collection and analysis, there is much similarity in the overall objectives and approach. Both regimes seek or require:

- Harmonized comprehensive reporting requirements, covering both solo undertakings and groups;
- Data analysis to identify key risks for insurers/groups and the market as a whole;
- A comprehensive database and repository, based on a harmonized IT format, to facilitate the analysis process at the solo, group and market levels; however, there is a difference in the main point of entry and repository for data (NAIC on behalf of the states in the U.S., national supervisory authorities in the EU);
- Disclosure requirements on undertakings/groups; and
- The use of reporting to monitor compliance with regulatory requirements.

In the EU, ORSA reporting will be in place under Solvency II. ORSA reporting will also be in place for the state-based regime in the U.S (see also the report of TC2 for ORSA reporting by groups).

**Topic 1:** Policy objectives in relation to reporting, data collection and analysis

This topic deals with the overall objectives of reporting requirements and of the related data collection and analysis.

*Key Commonalities*

A key component of both regimes involves reporting of data by solo undertakings and groups to, and the collection and analysis by, supervisory authorities.

Both regimes seek to ensure harmonized reporting to collect data needed for supervisory purposes; to ensure that publicly reported information is clear and not misleading; and to promote transparency, simplicity and fairness, while not being overly burdensome to smaller or less complex undertakings. In addition, both regimes seek to enable an assessment of an undertaking's solvency and overall financial condition, first and foremost, as well as its governance, its business, valuation principles, risk and risk management system, capital structure and capital management; to detect financially stressed undertakings; to support the off-site analysis and on-site exam processes; and to analyze market trends and risks to encompass a market level approach.

*Key Differences*

While the two regimes have the above objectives in common, there are differences in the means by which these objectives are achieved. In addition, there are differences in terms of the related supervisory processes that are in place today on a centralized basis as compared to what will be in place in the future. While individual U.S. states and EU Member States have their own experience and capabilities with regard to reporting, data collection and analysis, for purposes of this exercise consideration was given specifically to how those functions are harmonized and centralized, i.e., across the U.S. states and across the EU Member States.

For example, the state-based insurance regulatory regime in the U.S. has a mature harmonized reporting, data collection and analysis function that has been administered by the NAIC for years; it has evolved and will continue to do so. In the EU, while national reporting systems are also mature and continuously improving, Solvency II will put in place for the first time a harmonized prudential reporting and data collection process across EU Member States that, when fully operational and having matured with experience, should function in a similar way as that utilized by the state-based regime in the U.S. However, in the EU the first point of entry of information from undertakings and most of the data analysis will remain at the Member State level.

Finally, as it is important for the full understanding of all topics, we highlight that in the EU, with the Solvency II regime a clear distinction is made between accounting and prudential information. For the state-based regime in the U.S. prudential information is based on accounting with the application of prudential filters, while in the EU, Solvency II establishes valuation rules of assets and liabilities creating a distinction between accounting values and solvency values. For more information on this topic please refer to the TC3 report.

**Topic 2:** Reporting Requirements

This topic aims at describing the reporting requirements in the both regimes, especially with regard to content, structure and delays, and also with an emphasis on specific items like ORSA or groups.

*Key Commonalities*

For both regimes reporting requirements are based on the following elements:

- Regular and ad-hoc reporting;
- Reporting of both narrative/qualitative and quantitative information;
- Regular information provided quarterly and annually (with a more extensive set provided annually);
- Templates provided in a standardized format for regular reporting of quantitative information, and also in some cases for qualitative information.

More specifically, the following documents are to be filed with state insurance supervisors in on a regular (at least annual) basis:

- For the state-based regime in the U.S.:
    - Annual Statements and supplementary filings, including notes and quantitative schedules (e.g., investment schedules);
    - Quarterly Statements and supplementary filings (which are a core set of the annual ones);
    - RBC filings;
    - Management's Discussion and Analysis (MD&A);
    - Management's Report of Internal Control over Financial Reporting, for undertakings with more than $500 million in annual premiums;
    - Actuarial Opinion, and a more detailed Actuarial Memorandum;
    - Reinsurance attestation for P&C undertakings; and
    - ORSA filing (forthcoming, with exemptions based on premiums).
    - For listed companies, SEC filings are also available to supervisors, as well as the public.
- In the EU:
    - SFCR;
    - Regular Supervisory Report;
    - ORSA Supervisory Report;
    - Annual Quantitative Reporting Templates (QRTs);
    - Quarterly QRT (which is a core set of annual reports); and
    - Quarterly Financial Stability QRT, for undertakings over a certain size threshold.

In terms of filing deadlines for the submissions, there are some differences but the objective is the same with a longer submission deadline for annual filings:

- In the state-based regime in the U.S., annual filings are due March 1 of the subsequent year, and quarterly filings are due 45 days after the end of the quarter.

- In the EU, as of 2017[51], annual submissions are due 14 weeks after the financial year end, and quarterly submissions are due 5 weeks after the quarter end; groups have an additional 6 week deadline in both cases, except for financial stability purposes.

An important commonality of both regimes is that they rely in particular on standardized templates and schedules, which enable a harmonized transmission of comparable data (between undertakings, and between states) and facilitate its analysis. These standardized reporting requirements also aim at reducing the need for ad hoc requests.

Concerning the structure of narrative requirements, there is a slight distinction insofar as the structure of the narrative SFCR and RSR is imposed in the EU (but not the structure of the ORSA report), whereas more freedom is left to the insurer for the MD&A in the state-based regime in the U.S. However, in spite of this difference, there are many commonalities in terms of content, as described below.

Outside of regular reporting, both regimes allow for additional or more frequent (e.g., monthly) ad hoc reporting, especially in the case of a difficult financial situation of an undertaking, following pre-defined events, or to address market-wide issues or crises. Also, non-harmonized information is usually required within the different steps of the supervisory process, e.g., in preparing for an on-site inspection or responding to questions from supervisory analysts.

Concerning the content of regular reporting, many commonalities can be identified between the information required by both regimes, although the specific layout of the data may differ. In particular, the following main topics are addressed in both regimes, through narrative and/or quantitative requirements:

- Business and performance (U.S. states: MD&A; EU: SFCR and RSR);
- Risk profile (U.S. states: MD&A, actuarial memorandum, financial statements, ORSA, Enterprise Risk Report; EU: SFCR, RSR, QRT, ORSA report);
- Valuation methods and assumptions used (U.S. states: notes to financial statements, actuarial opinion and memorandum; EU: SFCR, RSR);
- Capital requirements and management (U.S. states: RBC filing; EU: SFCR, RSR, QRT); and
- Quantitative information on premiums, balance sheet, investments, technical provisions, own funds, capital requirements and reinsurance (U.S.: Annual Statement, notes to financial statements; EU: QRT).

An important common feature is that both regimes (in the EU under consideration) require the regular reporting of a detailed list of investments, enabling a thorough risk analysis

[51] Solvency II will most probably include a transitional period for reporting due dates (information will be due after 5/14 weeks for solo from 2017owards, but the deadlines will be longer for information to be reported with reference to the end of 2014, 2015 and 2016)

concerning assets, both at the entity and market levels, and reducing the need for ad hoc requests to assess such risks.

*Key Differences*

The main differences concerning content of regular reporting requirements are related to governance (including risk management; see also report of TC2 for governance requirements on groups): the EU includes a detailed description of the system of governance and risk management system in the narrative SFCR and RSR (which gives a first overview in order to enable further analysis especially on-site), while the state-based regime in the U.S. prefers the monitoring to occur mostly through on-site examination processes and focuses on expected outcomes, without including a description in regular reporting requirements as such, except specific information included in the financial statements and in Management's Report of Internal Control over Financial Reporting, for undertakings with more than $500 million in annual premiums. This will also be enhanced in the future on the U.S. side with ORSA and Enterprise Risk reports.

Concerning reporting on the ORSA, it will be put in place in both regimes over the coming years. However, in the EU, it is fully integrated within the Solvency II framework, whereas in the state-based regime in the U.S., the ORSA is still pending the implementation of the forthcoming model law, following the NAIC guidance manual on ORSA, and is not integrated in the capital framework as such. The content of the ORSA requirement in the state-based regime in the U.S. and the ORSA supervisory report in the EU is expected to present some commonalities, especially in terms of assessment of risks. Another difference is related to the scope of application, insofar as all undertakings submitted to Solvency II in the EU will have to perform an ORSA (and submit an ORSA supervisory report) at least annually, whereas in the state-based regime in the U.S. there will be exemptions based on premium volume or upon decision of a commissioner.

Concerning reporting requirements for groups, the approach is somewhat different between the two regimes. In the state-based regime in the U.S., groups submit holding company filings, which are distinct from requirements of individual undertakings and focus on IGTs rather than on consolidated data. In the EU, groups have to make similar submissions to that of solo undertakings, including SFCR (possibly a single group-wide document upon authorization of the group supervisor), RSR, QRT and ORSA report: the information required is similar to solo requirements but on a consolidated basis, and also includes group-specific additional requirements such as data on capital requirements, IGTs and risk concentrations. See also the report of TC2.

There are also some common requirements to both regimes with regards to groups, such as requirements to submit an organizational chart of the group or data on IGTs; there is also in both regimes the possibility to perform a single ORSA at the level of the group.

**Topic 3:** Database Systems

This topic addresses the means by which each of the two supervisory regimes provide for an electronic database to receive and store in a secured manner data reported by solo undertakings and by groups and in a manner that enhances data validation and analytical capabilities at the solo, group and market levels.

*Key Commonalities*

Both regimes seek/have a comprehensive database and repository to enable retrieval and analysis of information at the solo, group and sector levels. However, technological requirements and management responsibilities may vary.

*Key Differences*

In the EU each national supervisor currently maintains its own database and collects data directly from undertakings, usually in the form of Excel and PDF files. The EU does not currently maintain a centralized database; however, under Solvency II the EU will have a centralized database to be administered by EIOPA and which will function in parallel along with existing national databases of competent authorities in Member States and only to perform EIOPA tasks, which include:

- Coordinating cross-border supervision, facilitating the cooperation between supervisors, promoting convergence of supervisory practices, and monitoring proper implementation of a European single rule book applicable to all financial institutions in the internal market.
- Setting of the standards in the field of insurance and occupational pension supervision.
- Monitoring and assessing market developments in the area of its competences.
- Collecting of data to assess financial stability and to identify and monitor any systemic risk information in the area of its competences.

Additionally to the data collected from insurance undertakings, it is envisaged that EIOPA will also, among other items:

- Maintain a central investments database for assisting national supervisory authorities;
- Provide and maintain a database for some of the standard codes for data harmonization (although as part of a step-by-step approach), or
- Maintain a register of insurance and reinsurance undertakings, authorized in the EU.

EIOPA's Solvency II QRTs are to be captured in a format allowing data analysis, and it is envisaged that supervisors will use systems capable to process automated tasks based on the QRT and other information collected in the eXtensible Business Reporting Language format

and stored in electronic databases. EIOPA's database will comprise information reported by undertakings to national supervisors, where data validation occurs, and the information is then sent to EIOPA. The tools to analyze captured data will be developed by each supervisor in relation to their own database, and by EIOPA in relation to its EU-wide database.

In the U.S. state-based regime the NAIC maintains a centralized database to store the electronic statutory financial statements and supplemental filings collected from undertakings (unless waived for proportionality issues) as directed by state statute/regulation. The NAIC database captures in data table format all quantitative disclosures and some limited qualitative disclosures included in the statutory financial statements and supplemental filings and uses this data in automated prioritization and analysis tools; the entire statements and supplemental filings are also captured in PDF files. NAIC staff performs consistency and reasonableness validations on the tabled data. The NAIC database maintains 10 years of annual and quarterly data (and the related analytical tools' results), and is directly accessible by insurance supervisors in each state; prior years' data is rolled off and stored in historical data tables which are not directly accessible.

For the state-based regime in the U.S., a project is underway involving NAIC staff whereby a Legal Entity Identifier code would be assigned to each undertaking. This involves linking the Legal Entity Identifier code to the NAIC company code for each legal entity in the NAIC database (undertakings will not have to disclose; the NAIC will have the list in the database and do the match on the back end). Also, insurers will provide Legal Entity Identifiers for reinsurers and issuers of securities as data elements that will be captured in the statutory financial statements. In the EU side, the standard is being discussed and the usage of Legal Entity Identifier codes for insurers, reinsurers and securities issuers could be envisaged.

**Topic 4**: Analysis of the information

This topic addresses the means by which each of the two regulatory regimes provide for various levels of analysis at the solo and group level, across solo undertakings and groups, and at the market level.

4.1 Objectives

The objectives include:

- Monitoring compliance with regulatory requirements;
- Identifying risks and enabling risk assessments for solo undertakings/groups and the market as a whole;
- Understanding the current financial condition of the solo undertaking/group and its future trends, and identifying potentially troubled solo undertakings/groups;

- Supporting the update of the risk assessments or profile of the insurer along with update of the supervisory plans and considerations of further actions (e.g., meetings, contacts with other supervisors, supervisory measures);

- Analysis of information filed on an ad hoc basis for key transactions (e.g., significant acquisitions or outsourcing) or other pre-defined events (e.g., SCR breach); and

- Identifying and providing publication of overall industry/sector trends and developments of concern.

*Key Commonalities*

For each of these objectives both regimes share a high degree of commonality as to the overall approach and desired outcomes. However, specifics vary.

4.2 Maturity Level of the Analysis Function

*Key Differences*

There also will be some differences relating to the maturity level of the analysis function between the two regimes; while the U.S. state-based analysis system has been operational and refined over a 15+ year period, there are some aspects of the EU's analysis system (those pertaining to tasks to be performed by EIOPA) that will only be operational when Solvency II comes into force, although some specific analysis in relation to financial stability is already in place at the EU level.

4.3 Monitoring Tools and Financial Analysis Procedures

*Key Differences*

In the EU the Solvency II Directive (Art. 36.3) prescribes that the supervisors shall have in place appropriate monitoring tools that enable them to identify deteriorating financial conditions in an insurance or reinsurance undertaking and to monitor how that deterioration is remedied. While each national supervisory authority will make its own determination as to how to comply with that mandate, it is envisaged an increasing convergence of the supervisory review process. The analysis at a solo level is performed by the supervisor of the competent national authority. At the group level, the group supervisor is responsible for the analysis, in close cooperation with the supervisors involved in the college of supervisors.

As a first step on the convergence of the supervisory review process, EIOPA is currently developing guidelines on the SRP ("SRP Guidelines"), to identify the manner in which a risk-based, prospective and proportionate approach to supervision is to be achieved within the

process, with the objective of achieving the convergence of supervisory processes and practices, while ensuring sufficient flexibility for supervisors to be able to appropriately adapt their actions on a case-by-case basis, taking into account the specificities of the undertakings involved, their own national markets and other supervisory priorities.

According to these SRP Guidelines under development, the supervisory review process is to be conducted in 3 phases: Risk Assessment Framework, Review, and Supervisory Measures. In each of these phases a number of steps are defined. Under the Risk Assessment Framework, as a first step, it is envisaged that every insurer is subject to a high level assessment of the supervisory data reported to the supervisor, whenever regular or ad-hoc reporting is made. This high level analysis will lead to the attribution of a four category impact assessment and a four category risk assessment, which combined, will constitute the outcome of the risk assessment. This outcome will feed into the supervisory plan that establishes the need for and scope of the detailed off-site and/or on-site analysis. For the high level analysis described above, the frequency is set by the reporting frequency, and is expected to be performed on a quarterly basis. Although the process will be most probably defined in the future guidelines, the content of the analysis performed, the analysis tools and metrics at the different levels is not envisaged to be harmonized through the referred guidelines.

Finally, at the EIOPA level, financial stability analysis of market trends is currently already in place, under the remit of the Financial Stability Committee, which leads to the publication of a semi-annual financial stability report. This EIOPA task should develop in the coming years, especially with the availability of quarterly Financial Stability QRT.

The U.S. state-based regime incorporates common analysis tools and metrics which are developed and maintained by the NAIC and accessible for use by all state insurance regulators. These tools have been developed, utilized and enhanced over the past 15+ years to address ratios (overall, financial position, profitability, cash flow and liquidity, reserve, and leverage), scoring systems, trend and concentration reports (including RBC elements), and peer review tools. Among these ratios, the Insurance Regulatory Information System Ratios generate key financial ratio results that review profitability, liquidity, reserves, investments, and operations; and these results are public. The larger amount of prioritization and analysis tools, however are confidential. An NAIC prioritization tool, the Analyst Team System (ATS) was designed to incorporate many of these other tools and include a qualitative review by a central group of experienced regulators. In addition to these common NAIC tools, supervisors in each state develop their own tools to complement what is provided by the NAIC or to address unique needs in their state.

Similar to the EU, the analysis at a solo level is required to be performed by the supervisor of the domiciliary state. However, within the state-based regime in the U.S., non-domiciliary regulators often perform high level analyses of insurers writing business in their state, a practice that appears similar to what EU regulators participating in a college of supervisors would do to review a group.

The NAIC's Financial Analysis Working Group (FAWG), comprised of seasoned and highly experienced regulators, performs a separate analysis annually of nationally-significant insurers utilizing the various NAIC solvency tools as well as the research of NAIC staff supporting the FAWG. As mentioned in the report of TC6, the FAWG operates as a peer review mechanism, advising domiciliary states in follow up and regulatory actions.

In addition to the ATS, the NAIC Accreditation program requires that each state's financial analysis procedures be priority-based (and documented) to ensure that potential problem companies are reviewed promptly. Such a prioritization scheme should utilize appropriate quantitative and qualitative factors as guidelines to assist in the consistent determination of priority designations. For states with few domestic insurers, a more simplified prioritization system can be considered adequate; states with a larger number of domestic companies would be expected to use a prioritization scheme that is more complex and sophisticated. By comparison, the EU regime envisions more specific parameters to be used, but leaves it up to supervisor discretion to establish the actual prioritization methodology used. Also, the NAIC's Accreditation program establishes guidelines for timeframes within which analysis is to be completed.

Similar to the EU's guidelines being developed and based on Art. 36 of the Solvency II Directive, the NAIC Accreditation standard requires that a state insurance department's financial analysis procedures should ensure that domestic insurers receive an appropriate level and depth of review commensurate with their financial strength and position. The level and depth of the analysis will depend on the complexity and the financial strength of the insurer and the existing or potential issues and problems found during review of the financial statements, can be conducted cooperatively with other experts, such as actuaries, where necessary or indicated, and with at least one level of supervisory review on each multi-state company analysis performed by a supervisor. The quarterly statement assessment requirement is similar to the EU regime's expectation for the supervisor to perform and adequately document a high level analytical review for all insurers on a quarterly basis.

4.4 Documentation

*Key Commonalities*

In both regimes, there are also documentation requirements regarding analysis performed and for any regulatory action taken on material adverse findings. The NAIC also maintains a Financial Analysis Handbook which utilizes a Level 1 and Level 2 procedure structure. Level 1 procedures identify initial risks of concern, whereas Level 2 procedures should be considered for significant risks identified in Level 1 or for complex insurer operations that warrant such use. The Accreditation guidance indicates states may wish to use these checklists and tailor them to the needs of the analyst and the insurer under review.

As part of risk-focused financial surveillance in the state-based regime in the U.S., an Insurer Profile Summary is created and maintained as a living document updated after all regulatory

interaction with the insurer - prioritization, analysis, exam, corrective action - for each domestic insurer which highlights specific insurer information and concerns. This Insurer Profile Summary may also include information from on-site financial examinations such as any corporate governance or prospective risk areas of concern. The domiciliary regulator can share the Insurer Profile Summary with other regulators where the insurer is licensed. In addition, a Supervisory Plan is created for each insurer which outlines any necessary action or follow-up of important issues and indicates future actions such as targeted or full scope on-site examinations. The Insurer Profile Summary and the Supervisory Plan appear to be similar to the outcome of the Risk Assessment Framework and the supervisory plan established within the SRP Guidelines in the EU.

**Topic 5:** Public Disclosure Requirements

This topic aims at describing the public disclosure requirements in both regimes, especially in terms of contents, treatment of specific events and means of availability.

*Key Commonalities*

Both regimes require the disclosure to the public by solo undertakings of information, although not in the same level of detail as that received by supervisors.

There are also in both regimes extensive additional disclosure requirements for listed companies.

In addition, there are commonalities in the fact that, in both regimes, not all the solvency information is publicly disclosed, with more detailed and confidential information remaining reserved to the supervisor only.

*Key Differences*

In the EU, public disclosure concerns the SFCR (which encompasses both narrative information and a limited set of QRT), whereas in the state-based regime in the U.S., it concerns financial statements, the MD&A and actuarial opinion. However, the following elements are not to be disclosed: RBC and ORSA filings, actuarial memorandum in the state-based regime in the U.S.; RSR and most QRT and ORSA report in the EU.

Concerning groups, the requirements on the EU side are similar to that for solo undertakings, whereas, on the U.S. side, there is no extensive requirement other than SEC filings and some other specific examples (e.g., group organization chart and listing of non-routine affiliated transactions).

In terms of content publically disclosed, the SFCR in the EU includes quite detailed information on capital requirements and management, whereas the RBC filings in the state-based regime in the U.S. remain private (although the Authorized Control Level RBC results are publicly disclosed in the Annual Statement).

Another difference is that the EU regime requires SCR and MCR breaches to be disclosed after a given period of time without recovery (2 months if no realistic recovery plan is submitted, 6 months otherwise), along with any other major developments. In the U.S. state-based regime, specific ad hoc disclosures are limited to administrative and legal proceedings.

In terms of means of availability, the filings in the U.S. state-based regime are made available by the NAIC or through the states, whereas in the EU, it is the undertaking or the group which is responsible for making the SFCR available to the public, on in its website and in print upon request.

## 6. Supervisory Peer Reviews

**Overview**

This report provides an overview of the peer review processes operational in the European Union (EU) and under the state-based insurance regulatory regime in the U.S. The report focuses on the practices of EIOPA and the NAIC, referring to the activities of other institutions (e.g., EC), where relevant. The NAIC Accreditation Program and the EIOPA Peer Review Process constitute the main focus of the report (sections 1- 4). The report is structured to address issues relevant to the scope, process and outcomes of the Accreditation Program and the EIOPA Review Process. Where other peer review-type processes are considered relevant, they are separately referred to in the report (section 5).

**Topic 1: Scope**

1.1 Development Process

*Key Commonalities*

Review programs are developed by representatives of states/competent authorities that are the subject of the review. Non-regulators may provide input to the development of the program. In the state-based regime in the U.S., interested parties (industry, consumer representatives, trade groups) can provide input at the public portion of Financial Regulation Standards and Accreditation (F) Committee (FRSAC) meetings regarding any changes to the program or standards. For the EU, EIOPA Stakeholder Groups (comprised of representatives from industry, users of financial services, consumers, academia and trade unions) can provide input to the development of the work program.

*Key Differences*

**State-based regime in the U.S.:** The Accreditation Program was originally developed in 1989 as a collective effort between the state commissioners in the U.S. The standards/guidelines continue to evolve as the insurance industry changes and as financial solvency regulatory practices continue to improve and become more robust. Accreditation standards, guidance and any other accreditation-related decisions are made by the Financial Regulation Standards and Accreditation (F) Committee, which is comprised of 13 insurance commissioners. The Part A standards constitute minimum standards which assure a high level of regulatory authority and capability. An accredited state's laws/regulations must be substantially similar to the significant elements that have been identified as the key provisions of the model law or regulation. Although the state's laws and regulation do not have to be met exactly, they do have to be similar in force and no less effective than the model language.

Although the Part A standards are technically non-legally binding, combined with the sanctions for non-accredited status (other states will not rely on examination reports by a non-

accredited state) they have resulted in standards that are effectively obligatory. Since the inception of the Accreditation Program, all 50 states have adopted numerous laws/regulations that are based on NAIC-adopted models or templates.

**EU**: Topics for each peer review are proposed by the EIOPA Review Panel (the working group responsible for EIOPA's peer review activity, comprised of representatives from up to 30 EU/EEA competent authorities) and approved by the EIOPA Board of Supervisors (including the Heads of the 27 EU competent authorities with voting rights). Any EU measure within the scope of the EIOPA Regulation (Regulation (EU) No 1094/2010) can form the basis of a peer review. Hence, peer reviews cover measures which are legally binding (e.g., Regulations/Directives) and non-legally binding (e.g., guidelines/recommendations). Where the measures subject to assessment have a legal basis, the legislative power of the EU (as specified in the EU Treaty[52] provisions) does not rest with EIOPA, but is spread amongst the EU institutions (the key players being the Council of the European Union, the European Parliament and the Commission). EIOPA has the legal power to create certain non-legally binding measures, specifically guidelines and recommendations. The guidelines/recommendations require the approval of the EIOPA Board of Supervisors. See paragraph 2.4 below. Peer reviews can also focus on analyzing supervisory practices not prescribed in EU measures. The topics selected reflect significant supervisory, regulatory and/or legal issues which fall within the legal competence of EIOPA (see paragraph 1.2 below). The process allows EIOPA to respond to "live" issues (including regulatory and supervisory developments).



1.2 Scope

*Key Commonalities*

For both regimes, prudential issues fall within the scope of the review processes.

*Key Differences*

**State-based regime in the U.S.:** The accreditation standards deal with financial solvency regulation, but do not include market conduct issues. Specifically, the areas of financial solvency regulation that are included in the Accreditation Program are all of those areas that are fundamental to effective financial solvency regulation: laws/regulations (compliance check), financial analysis (offsite monitoring), financial examinations (onsite monitoring), information sharing and procedures for troubled companies.

**EU**: The peer review process covers prudential and market conduct issues (falling within the legal competence of EIOPA[53] as stated in the EIOPA Regulation), relating to insurance

[52] All EU legislation must be based on a specific Treaty article set out in the Treaty on European Union and the Treaty on the Functioning of the European Union.
[53] EIOPA Regulation – Art. 1

undertakings, reinsurance undertakings, institutions for occupational retirement provision, insurance intermediaries and financial conglomerates.

1.3 Objectives

*Key Differences*

The objectives of the processes are:

**State-based regime in the U.S.**: to assess whether state insurance departments are meeting minimum, baseline standards (that are rigorous in nature) in regulating the financial solvency of multi-state insurance companies;

**EU**: to achieve high quality supervisory outcomes, convergence in supervisory practices and the identification of best practices[54].

1.4 Coverage

*Key Differences*

**State-based regime in the U.S.:** The Accreditation Program includes a standardized scope with formal topical standards that is continually updated as necessary. Reviews of the standards are performed on a rotational basis. The areas forming the subject of the review do not, generally, change. Additional standards may be added for relevant changes in the insurance industry and/or the regulatory environment. The Program and related process have resulted in standards that are effectively obligatory.

Although the Accreditation Program focuses on multi-state insurance companies, the accreditation standards (i.e., topics) are not selected because it solely applies to multi-state companies. Rather, the vast majority of the standards apply equally to multi-state and single state companies, and the states apply the resulting processes equally to both types of companies.

**EU**: Peer reviews are thematic in nature, examining subjects/issues which fall within the legal remit of EIOPA. The topics forming the subject of the reviews change, but the EU measures, which are rigorous in nature, on which they may be based (e.g., Regulations, Directives and guidelines), will not generally change, but can be updated where necessary. Any significant issues identified will be revisited during the follow-up process (aspects may also be considered as part of a subsequent review).

The EIOPA Regulation specifies a non-exhaustive list of issues that should, as a minimum, form part of a peer review - e.g., adequacy of resources and governance arrangements; the

[54] EIOPA Regulation – Rec. 40 and Art. 30.

degree of convergence reached in the application of EU law and in supervisory practice[55]. Peer reviews extend beyond consideration of these minimum requirements. Topics selected for peer review are not restricted to issues relevant to multi-state insurance companies.

1.5 Participation

*Key Differences*

**State-based regime in the U.S.**: Participation in the NAIC accreditation process is voluntary. In order to maintain accredited status, a state must participate in full and interim annual reviews. Although the program is voluntary, there is a high degree of participation in the program. In fact, currently all 50 states, the District of Columbia and Puerto Rico are accredited. The vast majority of states have been accredited since the late 1990s. Because of the high degree of participation and peer pressure to be accredited, the Program and its related standards are effectively obligatory.

**EU**: The EIOPA Regulation requires EIOPA to periodically conduct peer reviews[56]. There is no express legislative requirement on competent authorities to participate in peer reviews. However, the additional obligations imposed upon competent authorities under the EIOPA Regulation (e.g., the requirement to provide EIOPA with all information - to which they have legal access - necessary to carry out the duties assigned to it by the EIOPA Regulation[57] (EIOPA's duties include peer review)), operate to support EIOPA's work in this area. All competent authorities continue to participate, voluntarily, in peer review exercises.

**Topic 2: Process**

2.1 Personnel

*Key Commonalities*

For both regimes, persons responsible for coordination of the process, ensure relevant procedures, etc. are followed.

*Key Differences*

**State-based regime in the U.S.:** NAIC staff responsible for coordination are involved in certain aspects of the review, but do not have a "vote" on a state's accredited status. Independent experts are also involved in certain aspects, some of whom are former regulators (past peers). NAIC staff have sole responsibility of performing the pre-accreditation review process and the review of the interim annual review.

[55] ibid., Art. 30(2)(a)-(d)
[56] Ibid., Art. 30(1)
[57] ibid., Art. 35

**EU**: Coordinators (EIOPA staff) support (i.e. do not undertake) peer reviews, through the fulfillment of project management, coordination, observer and advisory functions. EIOPA members are considered "peers" for the purposes of the exercise.

2.2 Legal Counsel/Advice

*Key Commonalities*

For both regimes a legal counsel is involved on a consultative basis.

*Key Differences*

**State-based regime in the U.S.**: NAIC Legal Division has a standing role in relation to the review of Part A of the Program (accredited states must have laws/regulations that are substantially similar to the 19 standards).

**EU**: EU legislation (e.g., Regulations/Directives) is binding. The EC is responsible for monitoring the transposition and implementation of Directives and the application of EU law. See paragraph 2.4.

2.3 Assessment of Supervisory Practices

*Key Commonalities*

**State-based regime in the U.S.:** The accreditation process includes a review of certain supervisory practices, including looking at actual cases to ensure proper procedures are being followed.

**EU:** The review includes the examination of actual supervisory practices – through, for example, examining actual cases and supporting documentation (e.g., case files, internal procedures); and cross checking the answers provided by one competent authority with those of another. This information will be requested of all competent authorities irrespective of whether the review activity is on-site or off-site.

*Key Differences*

**State-based regime in the U.S.:** The purpose of Part B is to assess whether a state insurance department is complying with baseline regulatory practices and procedures required to supplement and support enforcement of the state's financial solvency laws and regulations. These standards deal with all aspects of financial solvency regulation, including topics such as staffing, prioritization, material adverse finding, procedures for troubled companies, communication, supervisory review, appropriate procedure and sufficient documentation. In the Part B section alone of the Accreditation Standards there are 20 standards and 100 guidelines. Compliance with these standards is assessed for every state on an annual basis.

**EU:** Reviews extend beyond consideration of baseline practices, to examine (in respect of the areas subject to review) all aspects of the competent authorities' practices and any relevant national measures. For example, where the EU measures which form the basis of the reviews are intended to achieve minimum levels of harmonization, the review will consider supervisory practices and national measures which exceed the minimum thresholds. The key objective is to gain an understanding of an authority's supervisory approach and the outcomes achieved, as well as to foster consistency within the network of financial regulators[58]. The same approach will be adopted in respect of maximum harmonization measures.

2.4 Review of National Measures/Compliance Check

*Key Commonalities*

A review of national measures (e.g., laws, regulations, policies, etc.) takes place both in the U.S. and in the EU.

*Key Differences*

**State-based regime in the U.S.:** Part A of the accreditation standards focuses on a compliance check of items such as laws and regulations. In this section there are 19 different standards and the NAIC Legal Division reviews for compliance with 136 different significant elements. Laws and regulations are reviewed on an annual basis. In addition, during full on-site reviews, the accreditation review teams ensure that the state is properly administering key laws and regulations

**EU**: The application of legal and non-legal measures may be subject to peer review. Competent authorities are required to provide details of national measures (e.g., legislation, procedures, policies), which demonstrate how the competent authority would act in respect of the issues subject to review. The EC undertakes transposition/implementation checks (directives) and publishes respective transposition tables where required. The EC also monitors the application of EU legislation (including Regulations). Where a Member State fails to comply with EU law, the EC has powers ("action for non-compliance") to try to bring the infringement to an end. The EC can initiate infringement proceedings against Member States in the Court of Justice of the EU where possible violations are identified. EIOPA also has the legal power to investigate alleged breaches of EU law[59]. Furthermore, EIOPA has the power to adopt guidelines and recommendations which are treated by competent authorities on a "comply or explain" basis. EIOPA monitors compliance with such measures[60]. On request[61], or at its own initiative, EIOPA may also conduct an inquiry in order to assess potential threats to the stability of the financial system and make appropriate recommendations for action to the competent authorities concerned.

[58] Ibid., recital 40
[59] EIOPA Regulation –Art. 17
[60] Ibid., Art. 16
[61] Ibid., Art. 22 (4)

2.5 Reviewers

*Key Commonalities*

For both regimes, those responsible for conducting reviews are experts in insurance regulation, and appropriate steps are taken in order to avoid possible conflicts of interest.

*Key Differences*

**State-based regime in the U.S.:** Full reviews are undertaken by the Accreditation Team, which is comprised of persons approved to undertake the review. These "approved persons" cannot be employed in a state insurance department. They also file annual conflict of interest statement to ensure they do not perform a review of a state in which they have a conflict. The NAIC Accreditation Staff (involved in the coordination, pre-accreditation review and interim annual review) and Legal Counsel (involved in the review of Part A of the Program) are not approved (other than through the NAIC hiring process), but the restrictions on employment are identical**.**

**EU**: The reviews are undertaken by representatives from competent authorities ("peers") who are experts in the areas subject to review. These experts will be involved in all aspects of the review and are required to take all necessary steps to avoid conflicts of interest (e.g., members of the Review Panel and the reviewers must not be involved in the review carried out in respect of their own competent authority).

2.6 Disclosure

*Key Commonalities*

Requirements regarding the disclosure of information apply in respect of those performing the peer reviews in both regimes.

*Key Differences*

**State-based regime in the U.S.:** Accreditation reviewers are required to annually sign confidentiality agreements and individual contracts that include confidentiality clauses for each review performed.

**EU:** Reviewers are bound by an obligation of professional secrecy, as outlined in the (re)insurance directives[62]. The directives contain detailed provisions on professional secrecy, central to which is the basic principle that persons working or who have worked for

[62] Directives 2005/68/EC (Art. 24-30), 2002/83/EC (Art. 16) and 92/47/EEC (Art. 16). Identical professional secrecy provisions are included in the Solvency II Directive. EIOPA's Rules on Confidentiality (EIOPA-MB-11-008) should also be noted in this context.

competent authorities, are bound by an ongoing obligation of professional secrecy. The EIOPA Regulation applies the same professional secrecy obligations to EIOPA and its employees that apply to competent authorities in the EU.

## 2.7 Review Process

*Key Commonalities*

Review processes have been developed and are in use. The state-based regime in the U.S. has developed work plans and various accreditation review processes, while the EU has developed the Peer Review Methodology, Guidance for Reviewers and various review/report templates.

Common elements of both of the processes are:

- Review of relevant documents, including self-assessment questionnaires and files (responsibility for total number of files reviewed rests with team leader).
- Advance notification to state/competent authority of data needs.
- Questions posed to state/competent authority where issues are identified.
- Meetings with relevant persons within the state/competent authority.
- Meetings of review teams.
- Documentation of outcomes (aspects of which are reported to a central decision-making group and the relevant state/competent authority).

## 2.8 Onsite/Offsite Work

*Key Commonalities*

Both regimes have developed standard processes which involve elements of on-site/off-site work.

*Key Differences*

**State-based regime in the U.S.**: The review involves the use of on-site and off-site tools in respect of each state. Full on-site visits typically last 4.5 days, while re-review on-site visits last between 2-4.5 days. Both reviews include between three and six team members and one NAIC staff member. Off-site preparatory/"wrap up" work for on-site reviews take between 2-10 hours per state per team member. This amount of time does not include the off-site preparatory or wrap-up work of NAIC staff, which is quite significant in relation to the on-site

review work. The interim annual review (off-site) lasts from 5-12 hours per state. The estimates as to the number of people on the team and the number of hours for each review is based on over 20 years of experience of performing these reviews and the efficiencies gained in performing this process.

**EU:** When considering whether to conduct an on-site visit, account is taken of the non-exhaustive criteria as outlined in the Peer Review Methodology (i.e. the scale of potential market impact; extent of the misapplication of provisions; inconsistency or lack of clarity of questionnaire responses; failure to provide information when requested). The proposal to undertake an on-site visit will, following discussion within the relevant workstream, be subject to the agreement of the Review Panel.

The level of onsite activity differs depending upon the nature of the issues identified during the review. For example, 17% of competent authorities were visited during CEIOPS' first peer review in 2010, while in respect of the 3 exercises undertaken in 2012, 27% will be visited as part of one review and approximately 16% in relation to the others. On-site work will be undertaken by review teams comprised of a minimum of 3 reviewers and supported by an EIOPA coordinator. On-site visits typically last 2 days. The amount of time spent on-site depends on the specific circumstances of the competent authority. A minimum of 2 reviewers will be assigned to each competent authority for off-site work. Approximately 8 to 20 working days would typically be spent by each reviewer undertaking off-site work in respect of each competent authority – however, this could be longer, depending on the scope of the review. This estimate does not include the significant time spent by the EC undertaking transposition/implementation checks, etc. Decisions relating to how the reviews are staffed and the time allocated to each element of the review, are based upon the EU's previous experience in this area.[63]

## 2.9 Information

*Key Commonalities*

Information is obtained from states/competent authorities, including via self-assessment questionnaires (including supporting documentation) and through onsite visits, but can be supplemented/verified by other information to which the NAIC/EIOPA has access (e.g., data collected from insurance companies/information generated from work undertaken within EIOPA).[64]

[63] The peer review process allows for improvements in the application of EU measures and supervisory practices to be monitored and measured.

[64] When conducting peer reviews, EIOPA is under a legal obligation to take into account existing information and evaluations with regard to the competent authority concerned (EIOPA Regulation –Art. 30(1))

2.10 Frequency of Reviews

*Key Differences*

**State-based regime in the U.S.**: Each state's insurance department is reviewed on a periodic basis to assess compliance with the standards (full onsite accreditation reviews take place once every 5 years; interim off-site reviews take place annually).

**EU**: A maximum of 3 reviews per year may be undertaken simultaneously in respect of those competent authorities for which the subject of the review is relevant (not all competent authorities regulate the pensions and insurance sectors). Each review typically involves reviewing the activities of up to 30 competent authorities.

2.11 Grading/Scoring Systems

*Key Commonalities*

Grading/scoring systems have been developed for use during reviews both in the U.S. and the EU.

*Key Differences*

**State-based regime in the U.S.**: A scoring system is adopted which forms the basis of the recommendation regarding the state's accreditation. Part A of the program is scored on "pass/fail" basis. A numerical system (0 to 5) is applied in respect of Part B. Part B scores are for internal use only (i.e. NAIC staff/review team). Parts C and D are not scored but are assessed during the on-site visit.

**EU**: EIOPA has adopted a grading system (fully applied, partially applied, not applied) in order to facilitate the analysis and formal classification of the application of the measures subject to review. The grading system will only be applied in respect of those provisions which competent authorities are "required" to apply. The grades/benchmarking are available to the competent authorities, Review Panel and the EIOPA Board of Supervisors. Under CEIOPS, they were also published; under EIOPA Regulation this needs the agreement of the competent authority subject to peer review (see also 3.7). In respect of those measures/practices which are not benchmarked, they will be considered as part of the on-site visit/off-site review work.

**Topic 3: Outcomes**

3.1 Decision Makers

*Key Commonalities*

Outcomes are decided by a central decision-making group, comprised of representatives from states/EU competent authorities.

*Key Differences*

**State-based regime in the U.S.:** Decisions are taken by the Financial Regulation Standards and Accreditation (F) Committee, which is comprised of 13 insurance commissioners. Significant committee decisions regarding the program processes and standards must be approved by a vote of the full NAIC membership (total of 56 jurisdictions.)

**EU**: Preliminary decisions taken by the workstream responsible for conducting the review, are, once discussed and approved by the Review Panel (comprised of representatives from up to 30 EU/EEA competent authorities), presented to the EIOPA Board of Supervisors (including the Heads of the 27 EU competent authorities with voting rights) for approval. All decisions regarding the peer review program, processes and any EU measures adopted by EIOPA which form the basis of peer review, are taken by the EIOPA Board of Supervisors.

3.2 Documentation of Outcome

*Key Commonalities*

Outcomes are recorded and communicated by the EU and U.S. in reports which provide: an overview of the exercise; conclusions; recommendations; and action points. The draft reports are shared with the relevant state/competent authority which is afforded the opportunity to comment/discuss the issues raised. The state/competent authority must provide a written response to the final report.

3.3 Best Practices

*Key Commonalities*

Best Practices are identified and communicated widely in both regimes.

*Key Differences*

**State-based regime in the U.S.:** The reviewers identify the best practices and can notify the NAIC Senior Accreditation Manager for possible inclusion in the listing of best practices. NAIC staff or accreditation team may suggest that an item be included as a best practice in the NAIC Manual. State insurance departments may also suggest that one of their practices be considered as a best practice. The NAIC Senior Accreditation Manager has final approval on whether the item is considered a best practice. The best practices are communicated to the state supervisory departments through the NAIC Manual, but not made public. Although, when a best practice is identified, it could likely end up as additional language in the NAIC analysis, examination or troubled company handbooks and would become public when so

proposed; but it may not be disclosed that the source of the idea came from an accreditation review.

**EU:** Best practices are identified by the reviewers, discussed by the Review Panel and other relevant working groups within EIOPA and once agreed by the Review Panel, proposed to the EIOPA Board of Supervisors for approval. EIOPA is legally required to make the best practices that can be identified from peer reviews publicly available[65]. Best practices are published on the EIOPA website (see paragraph 3.7 below).

3.4 Addresses

*Key Commonalities*

The outcomes are directed to the subject of the review (i.e. state/competent authority).

*Key Differences*

**State-based regime in the U.S.**: Outcomes become known to other states through FRSAC activities and NAIC National Meetings. Further, if a significant issue is identified on a review related to NAIC handbooks or guidance, FRSAC can make a referral to the appropriate group with suggested revisions.

**EU:** Outcomes may also be directed to other parties. Where, for example, EU measures which form the basis of the review are considered to require revision, the matter can be referred to the EC and/or EIOPA.

3.5 Nature/Impact of Outcome

*Key Commonalities*

The outcomes of the processes in both regimes are not binding, although peer pressure and/or follow-up mechanisms may enhance compliance and lead to improvements in performance.

*Key Differences*

**State-based regime in the U.S.:** Outcomes are not binding per se, but a state could lose its accreditation based on noncompliance with the accreditation standards. Because of the high degree of participation and peer pressure to be accredited, the Program and its related standards are effectively obligatory.

**EU:** On the basis of a peer review, in addition to identifying and publishing best practices, EIOPA may issue guidelines and recommendations. Guidelines and recommendations are not

[65] ibid., Art. 30(4)

legally binding, but subject to the "comply or explain" regime (see paragraph 2.4 above). EIOPA shall also take into account the outcome of peer reviews when developing draft Regulatory Technical or Implementing Technical Standards in accordance with articles 10-15 of the EIOPA Regulation[66].

### 3.6 Challenge/Appeal Process

*Key Commonalities*

It is possible to challenge/appeal the outcomes of the review process. In both regimes, decisions are taken by simple majority of representatives of the state/competent authority (state-based regime in the U.S.: 3 members of the Appeal Hearing Panel; EU: Review Panel; Board of Supervisors). Further, the appealing authority can be supported by, or request the participation of, relevant experts (Legal Counsel; members of the review team) in the appeal/challenge process. The burden is on the relevant state/competent authority to justify the reversal of/changes to, the initial decision. The appeal/challenge process can result in the affirmation, reversal or modification of the decisions/conclusions of the FRSAC/Review Panel as they relate to the particular state/competent authority.

### 3.7 Publication

*Key Commonalities*

Both regimes publish general information regarding the review process alongside best practices.

*Key Differences*

**State-based regime in the U.S.**: Publication of the Accreditation Program and its processes and a listing of accredited states are publicly available. Accreditation reports are confidential.

**EU:** The EIOPA Regulation provides that the competent authority that is the subject of the review must consent to the publication of the results of the peer review[67] (other than best practices – which will always be published). Historically, the peer review process involved publication (via the CEIOPS website) of competent authorities' self-assessment questionnaires; an interim report which (on a named basis) provided a statistical overview of compliance levels (including grade scales); and the final report on the exercise, which outlined specific issues/recommendations on a named basis.

[66] Ibid., Art. 30(3)
[67] Ibid., Art. 30(4)

**Topic 4: Follow-Up**

*Key Commonalities*

The state/competent authority must provide a progress report/update on actions taken in response to the issues identified/recommendations resulting from the review. Such updates will typically be provided on an annual basis, but depending on the significance of the relevant issues, could be more frequent and may vary in form.

**Topic 5: Additional Review-Type Projects/Processes in Each Regime**

There are several processes, in addition to the NAIC Accreditation Program, which the state-based regulatory regime in the U.S. classifies as peer review activities (outlined below). Where EU processes exist, although not technically classified by the EU as peer review activities, but which share some of the characteristics of the processes in the state-based regime in the U.S., these have been noted. The EU has, however, confined the description of the EU activities to the work undertaken by EIOPA which bears some correlation to the activities presented by the U.S. and has not reflected in the report the workstreams undertaken by EIOPA more generally.

The following peer review-type projects/processes are in addition to the **NAIC Accreditation Process**:

**NAIC Exam Peer Review Project**

The NAIC's Exam Peer Review Project provides an opportunity for participating regulators in learning from each other and developing best practices in conducting risk focused examinations. Through each quarterly session, a group of experienced regulators from various Member States come together to review examination files submitted by other states and provide feedback to those states regarding the effectiveness of the work performed and suggestions for improvement. Feedback is provided through a formal letter that is issued to each state's chief regulator overseeing the on-site examination process. General results of the peer review findings are incorporated into the NAIC's process to update existing guidance for use in conducting examinations nationwide.

**Financial Analyst Peer Review Process**

FAWG was formed in 1989 and is a regulator-only group that is comprised of state insurance department solvency experts from sixteen states. Individual members of the Working Group are chosen by their skill sets and regulatory solvency experience. The group is charged with:

- Analyzing nationally significant insurers and groups that exhibit characteristics of trending toward or being financially troubled and determine if appropriate action is being taken.

- Interacting with domiciliary regulators and lead states to assist and advise as to what might be the most appropriate regulatory strategies, methods and action(s).

- Support, encourage, promote and coordinate multi-state efforts in addressing solvency problems, including identifying adverse industry trends, including coordination and consultation with the International Association of Insurance Supervisors Supervisory Forum.

- Increase information-sharing and coordination between state regulators and federal authorities, including through representation of state regulators in national bodies with responsibilities for system-wide oversight.

- Review and update to the NAIC Troubled Insurance Company Handbook

This peer review process has become a fundamental and essential part of the NAIC Solvency Framework. The creation of the FAWG emphasized the importance of the responsibility of insurance regulators to discover and engage in the handling of troubled insurance company situations. FAWG conducts its peer review process quarterly.

The following reflects some additional related **EU Workstreams/Processes:**

**Review Forums**

As part of the EU review process, review teams can hold "review forums" which bring together several competent authorities in order to examine in greater detail (through open discussion, review of documentation, presentations, etc.) specific practices that have been identified during the review. The reviewers will use the information they acquire during the forum to inform the outcomes of the review process both in relation to the competent authorities participating in the forum and more generally. The EU process relating to the outcomes of the review (section 3 above) is also relevant in this context.

**Selective EIOPA workstreams (illustrative of review-related activities)**

Various EIOPA working groups comprised of relevant experts from competent authorities (including the Financial Stability Committee; Internal Monitoring Group; Task Force on Crisis Management; and the Colleges Team), are charged with:

- Analyzing the position of European insurers, based on, for example: (i) quarterly data from the 30 largest insurance groups; (ii) the outcome of EU wide stress tests

(performed to assess the resilience of financial institutions, in particular, the systemic risk posed by financial institutions to adverse developments); and (iii) undertaking specific information regularly presented by the EIOPA Board of Supervisors

- Identifying, assessing and monitoring risks, including through the development (in conjunction with national competent authorities), of a Risk Dashboard, in order to examine the main risks and vulnerabilities faced by insurers.

- Assessing (during onsite visits) (i) the ability of competent authorities to conduct financial stability analysis on a set of indicators; and (ii) how issues relating to significant national insurance undertakings are being addressed.

- Providing regular feedback to the EIOPA Board of Supervisors on insurance sector and financial market analysis, and individual competent authorities (as appropriate), in order to inform supervisory planning (including the presentation of policy options and proposals for supervisory action).

- Facilitating voluntary, coordinated action by competent authorities, including where adverse developments may seriously jeopardize the orderly functioning and integrity of financial markets or the stability of the financial system in the EU.

- Contributing to EU and international policy developments, including those relating to: - crisis pre-emption/prevention/management; and recovery/resolution for insurers.

- Operating as a forum for competent authorities to: exchange information; discuss emerging issues (including risks); promote supervisory convergence and identify/develop good supervisory practices (including through the development of a Supervisory Handbook[68] and EIOPA's participation in colleges of supervisors[69]).

The activities described above constitute important examples of the review work undertaken by EIOPA (at a macro and micro level) of the EU insurance sector, that have facilitated EIOPA's ability to fulfill its legal powers including those in respect of:- financial stability; crisis prevention, management and resolution; emergency situations; systemic risks, colleges of supervisors; and general coordination between competent authorities[70].

[68] The Supervisory Handbook will be a 'good practices' document, providing information on how to carry out supervisory activities under the Solvency II Directive.
[69] EIOPA Regulation, Art. 8(1)(i) and 21
[70] Relevant articles in the EIOPA Regulation include Art. 9, 18, 21, 22(4), 24-25, 27 and 31

## 7. Independent Third Party Review and Supervisory On-Site Inspections

**Executive summary:** TC7 covers significantly different areas of external scrutiny, internal controls and supervisory inspections within the supervisory regime. Specifically, this report covers three key topics, independent audits, actuarial reports and on-site examinations. With the exception of the independent audit topic, the front sections of this TC7 report compare current/implemented policies and procedures under the state-based insurance regulatory regime in the U.S. with anticipated EU policies and procedures.

In addition, and with regard to the supervisory regime in the EU, each topic has been reviewed from the perspective of different time periods, as follows:

- When Solvency II will be fully implemented, based on published directives and guidance that describe what will be in place at that time. This aspect of TC7's review was limited in part, e.g., because the EU's draft SRP Guideline (for further information, please refer to TC5, 4.3) is not yet publicly available and was thus not available for inspection by TC7 members in the U.S. either.

- Current practices, as determined from a survey of a selected EU Member States and as described in the last section of this report.

In the area of audits, the two regimes are largely the same and can be compared easily. The main difference lays in the Solvency II requirement of an internal audit function, which is a common practice and a SEC-filer requirement in the U.S.

For the topic of on-site examinations, the two regimes are conceptually the same – providing authority for supervisors to conduct examinations on the solvency and financial condition of insurers to ensure policyholder protection using a risk-focused examination approach. However, key differences exist within the application of the regimes. These differences include state insurance regulatory requirements in the U.S. that prescribe the frequency of examinations, a process for completing risk-focused exams, example tests of controls and examination procedures to address specific risks and assertions, training and certification programs for examiners, minimum examination report components and activities to ensure consistency between states, which are not currently envisaged in the EU under Solvency II.

For the area of actuarial reports, the two regimes mandate an established actuarial function, and specify requirements for those that complete that function. In the U.S., state insurance regulatory requirements include adherence to professional standards mandated by a professional actuarial association, whereas the EU does not require this membership. Also, although both regimes require actuarial reports, the prescribed minimum content and distribution of reports are different. In the U.S., actuaries are required by state insurance regulations to release a public opinion, along with other reports that are restricted to the company and supervisors. In the EU, there is no public opinion, but internal reports can be accessed by supervisors.

**Topic 1:** Independent audit

This topic covers the following: (a) Requirement and nature of external audit of statutory financial statements, and (b) regulation on external audit, including (i) professional requirements for an auditor, (ii) publication and scope of an audit report, (iii) auditing standards, and (iv) internal audit functions.

***Key Commonalities:***

Both regimes have Directives/Regulations in place that require an annual external audit of the statutory financial statements of insurance undertakings. For the EU that requirement stems from Directive 91/674/EEC.

Both regimes have Directives/Regulations in place that specify the individuals who can perform the annual independent audit. The EU requirements are stated in Directive 2006/43/EEC. The requirements ensure that the audit is conducted by professionals that under both regimes undergo professional examinations and on-going education. Under both regimes auditors have to comply with comparable extensive educational qualification and professional ethics requirements. Further, the EU regulation forces the Member States to introduce quality assurance regimes to enable external scrutiny on the work of the licensed auditors. Similarly, professional practice requirements for auditors in the U.S. require them to have quality assurance regimes in place. Auditors of SEC filers are also required to register with the Public Company Accounting Oversight Board, which introduces further regulation and oversight on the auditors of public companies. This can also be seen as comparable with the required system of public oversight for statutory auditors and audit firms within the EU. The following identifies the specific individual requirements under both regimes:

- U.S.: Certified Public Accountant that has sufficient qualification and experience in auditing insurance companies on a statutory accounting basis.

- EU: Person authorized, according to its qualifications, by national law to audit accounts.

Both the regimes have Directives/Regulations in place that specify the scope of the audit. The relevant EU provisions are set out in Directive 91/674/EEC. Items included in the audit are: the financial position of the insurer, the balance sheet, the profit and loss statement and the corresponding notes, which provide explanations and additional information on the items of the balance sheet and income statement. The audit also includes a cash flow statement, changes in equity and the distributable surplus for the reporting period. Both EU insurers and SEC filers publish more extensive financial information, such as a management commentary or a “MD&A”, which is also reviewed by their auditor. (In the U.S. all statutory filers include an MD&A within their statutory financial statements; however, it is not a required audit element unless the company is an SEC filer.)

Under both regimes the financial reports of insurers, together with the corresponding audit reports and the audit opinions, are filed with a supervisory authority and become public documents. The audit reports in both regimes have the same objective, comparable scope and structure. In addition, according to both regimes, the auditors have to promptly report any facts which are likely to have a material effect on the insurer's financial situation. This also covers, for example, misstatements or non-compliance with capital requirements. According to both regimes the insurer needs to make all relevant information available to the auditor, the audit committee and the supervisor. For the EU those requirements are determined by Directive 91/674/EEC.

The auditing standards used in both regimes are comparable, if not the same; the EU Directive 2006/43/EC assumes the use of international auditing standards. All EU Member States' authorities have implemented the International Standards on Auditing (ISAs) as issued by the International Auditing and Assurance Standards Board. The requirements of the AICPA in the U.S. are compliant with those ISAs.

Insurers in both regimes are required to set up an audit committee or are allowed to delegate that function to the Board of Directors. The audit committee, amongst other tasks, monitors the financial reporting process, including the corresponding internal controls, the statutory audit, the independence of the auditor and looks after the appointment and compensation of the auditor. The requirements on the set up, code of conduct, the expertise and knowledge of the audit committee members are comparable in both regimes. Audit committees monitor the effectiveness of the insurer's internal controls. The EU Directive 2006/43/EEC, relevant for the regulation of audit committees, expands the audit committee function to monitor the internal audit function and risk management regimes.

***Key Differences:***

According to Directive 91/674/EEC in the EU all insurers are required to have their annual accounts and consolidated accounts audited. In the U.S., audits are not required for insurers that are below the threshold of less than 1,000 policyholders or if they have annual premium income of less than $1 million. Also in the EU, all insurers are required to have their consolidated accounts audited, if applicable. In the U.S., regulatory reporting is on a separate-legal entity basis, and only public filers (filing under the SEC) are required to have their consolidated financial statements audited.

In the EU, the Solvency II Directive (2009/138/EC) requires the establishment and maintenance of an internal audit function. Solvency II foresees an independent internal audit function to play a vital role within the systems of governance for an insurer (see also TC2 for governance). There is no independent internal audit function currently required under state or U.S. laws or regulations; however, insurers listed with the New York Stock Exchange are required by the terms of membership on the Exchange to have an internal audit function. In addition, it is common practice in the U.S. for insurers, especially but not limited to larger ones, to have an internal audit function. Current discussions within the NAIC pertaining to corporate governance have discussed implementing state requirements for an internal audit function for insurers over a certain size.

**Topic 2:** Onsite examinations

This section of this document compares current/implemented policies and procedures of the state-based regime in the U.S. with anticipated EU policies and procedures. Although the Solvency II Directive has been adopted, it has yet to be transposed into Member State laws and implemented in practice. For example, this section does not consider certain provisions that have yet to be consulted upon in the EU, such as the SRP Guidelines.

This topic covers the following: (a) the powers, responsibilities and objectives in relation to on-site examinations (b) the frequency of the on-site examination; (c) the examination scope and procedures; (d) the report of the on-site examination; and (e) consideration as to how consistency is achieved across examinations of insurers generally, as well as across U.S. states and EU Member States.

2.1 Powers, responsibilities and objectives

***Key Commonalities:***

Supervisors in both regimes are provided the necessary authority to conduct on-site examinations. These examinations may cover not only the business and financial condition of the insurer, but also the examination of a person if it is necessary to the examination of the company. Finally on-site examinations can be conducted of insurer functions and activities that are outsourced.

The objective for regulatory examinations in both regimes includes focus on the solvency and financial condition of the insurer in order to ensure policyholder protection and compliance with statutes/regulations. To ensure this, all information should be made available to the supervisors.

Also, a risk-focused approach is utilized in preparing and scheduling the on-site examinations to be performed and also in conducting the supervisory exams. In both cases the examination could include a combination of off-site activities and on-site inspections and the off-site analysis informs and contributes to the prioritization of the on-site examinations.

In the U.S. as of January 1, 2010, a new approach to on-site examinations by the states became required for all full-scope financial examinations. The intent of this new risk-focused surveillance approach is to broaden and enhance the identification of risk inherent to an insurer's operations and utilize that evaluation in formulating the ongoing surveillance of the insurer and in conjunction with other supervisory activities. A risk-focused surveillance process includes identifying significant risks, assessing and analyzing those risks, documenting the results of the analysis, and developing recommendations for how the analysis can be applied to the ongoing monitoring of the insurer.

In the EU, the Solvency II Directive will incorporate a risk-focused approach framework similar, in the objectives, to the one prescribed in the NAIC Financial Condition Examiners Handbook (Handbook).

2.2 Frequency

***Key Commonalities:***

Both regimes have regulations in place that allow supervisors to conduct examinations of all companies writing insurance business in their states as often as necessary.

***Key Differences:***

The state-based regime in the U.S. requires a full-scope financial examination to be performed at least once every five years. Under the Solvency II Directive there are no frequency requirements for examinations.

2.3 Examination procedures

***Key Differences:***

In the U.S. the Handbook prescribes how to conduct the examinations of insurers. The Handbook prescribes seven distinct phases required to be completed for each examination:

- Understand the Company and Identify Key Functional Activities
- Identify and Assess Inherent Risk in Activities
- Identify and Evaluate Risk Mitigation Strategies/Controls
- Determine Residual Risk
- Establish/Conduct Detail Examination Procedures
- Update Prioritization and Supervisory Plan
- Draft Examination Report and Management Letter

In the EU, although the Solvency II Directive will incorporate, as referred, a risk-focused approach framework, it does not detail the examination processes to complete a risk-focused exam that would be similar to what is prescribed in the Handbook.

In the U.S., individuals who conduct the off-site (financial analysts) review are often "in-house" analysts, i.e., they are not the same persons who conduct the on-site examinations (financial examiners). Training and certification programs help to ensure consistency between

states in conducting examinations. The Handbook provides examples of tests of controls and tests of details to address specific risks and examination assertions. Although exam procedures are completed based on the assessment of risk, the use of this examination repository allows regulators the ability to more consistently apply examination procedures when similar risks are identified.

Under the Solvency II Directive, there is no separation of functions for examinations or established example exam procedures for application. Also under the Solvency II Directive, although training is being developed at EIOPA level, there are no certification programs within the EU Member States.

2.4 Report

***Key Commonalities:***

In both regimes the on-site examination should lead to a report.

***Key Differences:***

In the state-based regime in the U.S., minimum examination report components for on-site examinations exist. The report has a required format for presenting the findings for on-site inspections, including sections on the scope of the examination, a summary of significant findings, a summary of management and control, financial statements, and a summary of recommendations. Examination observations that are not appropriate for inclusion in a public report, including findings of a proprietary nature, may be communicated to the company through other confidential means. Also, the company has the right to comment on the draft report, which includes a 30-day review period and the right to request a hearing. In addition, the NAIC's Model Law on Examinations specifies the process to make the report available to the public for review, which typically includes an additional 30-day waiting period after the report has been finalized and adopted. Also, there are requirements for the examination report to be shared with other states where the insurer is licensed and/or writing business. Examination reports are considered public documents, and many state insurance departments regularly post them on their websites.

In the EU, under the Solvency II Directive, there are no minimum report components or requirements to share the examination report.

2.5 How consistency is achieved

***Key Differences:***

State insurance regulators in the U.S. have in place a number of activities that ensure the consistency of examinations in practice:

- The detail of the Handbook provides for the application of the procedures and guidance as to steps to be followed.
- All states, through their laws or regulations, require the use of the Handbook.
- The development and up-date of the Handbook is based on the supervisors experience which facilitates the implementation.
- The NAIC accreditation process, further described under TC6 report, allows compliance assessment and "a peer review process."
- The application of actions or measures in relation to "nationally significant" insurers is also evaluated and challenged by NAIC's Financial Analysis Working Group, to ensure a greater level of convergence in these cases.
- The standardized training program both at the NAIC and the state level is also considered crucial.

**Topic 3:** Actuarial involvement and reporting

This section of this document compares current/implemented policies and procedures in the U.S. with anticipated EU policies and procedures. Although the Solvency II Directive has been adopted, it has yet to be transposed into Member State laws and implemented in practice. This section does not consider certain provisions that have yet to be consulted upon in the EU. For example, it appears that EU details on actuarial opinions have yet to be developed. This topic covers the following: (a) the tasks and responsibilities of the actuary/actuarial function (b) qualifications of the actuary; and (c) the scope of the actuarial report.

3.1 Tasks and responsibilities

***Key Commonalities:***

Both regimes have established requirements for insurers to maintain a viable actuarial function, and both specify requirements for individuals to conduct the actuarial function.

3.2. Qualifications

***Key Differences:***

Some EU Member States currently have a concept similar to that in the U.S. of an appointed or responsible actuary, but they have different functions in different Member States.

In the U.S., to be an appointed actuary, one must meet regulatory requirements of a "Qualified Actuary." To be a Qualified Actuary, the individual must meet specific education, experience, and continuing education requirements, as well as various conditions established under the

NAIC's Actuarial Opinion and Memorandum Regulation. Actuaries are required to adhere to professional standards (via association with a professional actuarial association).

In the EU (Solvency II Directive), persons performing key functions (including the actuarial function), are to be fit-and-proper. This means that persons who perform the actuarial functions needs at all times to fulfill the following requirements: (a) Have professional qualifications, knowledge and experience adequate to enable sound and prudent management (fit); and (b) be of good repute and integrity (proper). The "fit and proper" requirement does not require membership in a professional actuarial association.

3.3 Report

***Key Commonalities:***

Both regimes require the actuarial function to produce a written annual report.

***Key Differences:***

The prescribed minimum content and distribution of reports differs.

In the state-based regime in the U.S., the actuarial function issues an opinion as a public document that is submitted to the state supervisors (and becomes a public document), the NAIC and to the company's Board of Directors. In the EU (Solvency II Directive), the actuarial report is not considered an opinion; it is an internal report and is not addressed to the supervisory authority. In the EU, the supervisory authority can request the report, but it is not considered a public document. Furthermore, until implementation of Solvency II, it is not possible to assess whether the EU actuarial report will be similar to the state-based regime in the U.S. In the U.S., in addition to the public actuarial opinion, the actuary must prepare an Actuarial Memorandum and a Regulatory Asset Adequacy Issues Summary (for life insurance) and an Actuarial Report and Summary (for P&C insurance). The Actuarial Memorandum is confidential and is given to the company's Board of Directors. However, the state supervisor can request a copy. The Regulatory Asset Adequacy Issues Summary is confidential, but is filed with the state supervisor and given to the Company's Board of Directors. The Actuarial Report is confidential and is available to the regulators and the Board of Directors. The Actuarial Opinion Summary is filed confidentially with the regulator. In the EU, work under development on system of governance will aim at further convergence of a minimum content of the report.

Both regimes have requirements for actuarial involvement in aspects of reserve analysis (technical provisions). The EU's actuarial function also encompasses opinions on the underwriting policy and the overall reinsurance policy. In the U.S., some aspects of the actuarial work will touch on these issues (e.g., the illustration actuary must opine on the supportability of the current dividend scale for par business; an actuary must disclose issues related to non-guaranteed elements in insurance contracts – which is impacted by

underwriting and investment policy). The actuary must comment on significant risks that could impact financial reporting of reserves, which may include issues involving reinsurance collections, etc. The EU (Solvency II Directive) also requires the actuarial function to contribute to the effective implementation of the risk-management system, in particular with respect to the risk modelling underlying the calculation of the capital requirements (see TC3) and to the own risk and solvency assessment. In the U.S., it is expected that actuaries be involved in those processes, but it is not a state regulatory requirement.

Actuarial Detail Review - In the U.S., there are laws and regulations that require minimum insurance benefits for certain contracts that are reviewed by internal or external actuaries. In the EU this is a contractual feature and it is not set by Solvency II, although individual Member States may set their own requirements in this area.

**Topic 4: Member State Survey**

As noted above, and with the exception of the independent audit topic, the preceding sections of this report compare current/implemented policies and procedures of the state-based regime in the U.S. with anticipated EU policies and procedures. As Solvency II Directive has yet to be transposed by the Member States, to provide an indication of current practices in the EU with respect to on-site examinations and actuarial involvement, a limited survey was performed of such current practices in five EU Member States, each of which provided responses to a brief questionnaire and supporting documentation. The survey questions focused on certain supervisory requirements, processes and procedures for performing on-site inspections and for actuarial involvement by undertakings in general; the survey did not solicit information about how those may have been applied as regards any particular undertaking. However, it should be noted that the SRP Guidelines under development aim at further convergence of the supervisory review process within the EU.

Based on the limited survey, many of the differences between the state-based insurance regulatory regime in the U.S. and the EU Solvency II regime related to on-site examinations and actuarial involvement identified in the preceding sections of this report were also noted at the Member State level. In other words, where the two regimes have differences in these areas, similar differences tend to exist when comparing the state-based regime in the U.S. to the current practices in the EU based on the limited survey results.

For example, under the Solvency II Directive there are no specific frequency requirements for examinations. Four out the five Member States surveyed indicated that under their current practices there also are no specific frequency requirements, although one Member State reported that examination frequency is based on the market impact of the insurer (ranging from no specific requirement – as often as necessary – for those with the largest market impact, to every 10-12 years for those with the lowest market impact). In the U.S., state insurance regulators also can conduct an examination of any insurer writing insurance business in their state as often as necessary, but the regulators also require that a full-scope financial examination of an insurer be performed at least once every five years.

Other examples include that, for three of the five Member States surveyed, it appears that written guidance outlining how a risk-focused examination should be performed exist although with different levels of detail; for the other two there does not appear to be detailed written guidance outlining how a risk-focused examination should be performed; and none of the Member States surveyed appeared to have specific requirements outlining the contents of examination reports or how the results of on-site examinations would be shared with other relevant supervisors.

In relation to actuarial involvement and reporting, one Member State does not require the use of an appointed actuary. Those that do have requirements in this area allow for flexibility in suitability qualifications by allowing general fit and proper evaluations as opposed to requiring specific credentials. Not all of the Member States surveyed require the person to be an actuary by training (through a professional society); some allow a person with mathematics/statistics background to perform the function. Not all lines of business require an appointed actuary (actuaries tend to be required for life insurance and only specific non-life lines of business). The actuaries' responsibilities also vary by Member State (e.g., opine on technical provisions, pricing, etc.).

## Appendix I – Acronyms and Abbreviations

The following abbreviations and acronyms are used throughout the accompanying seven technical committee reports. The table below defines each as they are used in the reports, along with an indication as to whether they emanate from a topic or subject matter that is EU-based, US-based (e.g., state or federal), or relevant to both.

| Abbreviation or Acronym | EU | US | Definition |
|---|---|---|---|
| ACL | | √ | Authorized Control Level, an RBC-based regulatory action threshold in the state-based regime in the U.S. |
| AICPA | | √ | American Institute of Certified Public Accountants, the professional organization of Certified Public Accountants in the U.S. |
| ATS | | √ | Analyst Team System, a peer activity of state insurance regulators in the U.S. and which is administered by the NAIC |
| BHC | | √ | Bank Holding Company, a holding company whose entire corporate group is subject to consolidated supervision in the U.S. by the Federal Reserve by virtue of its ownership of a bank |
| CAL | | √ | Company Action Level, a minimum amount of capital determined by RBC, below which corrective action by state insurance regulators in the U.S. would be taken (if not already taken based on criteria other than RBC) |
| CEIOPS | √ | | Committee of European Insurance and Occupational Pensions Supervisors, the predecessor organization to EIOPA |
| Credit for Reinsurance Models | | | NAIC Credit for Reinsurance Model Law (#785) and NAIC Credit for Reinsurance Model Regulation (#786) |
| Dodd-Frank Act | | √ | Dodd–Frank Wall Street Reform and Consumer Protection Act, which was enacted into federal law in the U.S. in 2010. |
| EC | √ | | European Commission (comprised of 27 Commissioners), one of the main institutions of the European Union, representing and upholding the interests of the EU as a whole, amongst others, oversees and implements EU policies by enforcing EU law (together with the Court of Justice) and represents the EU internationally, for example, by negotiating international trade agreements between the EU and other countries. |
| EEA | √ | | European Economic Area, established on 1 January 1994 following an agreement between the Member States of the European Free Trade Association (EFTA) and the European Community, later the European Union (EU). Specifically, it allows Iceland, Liechtenstein and Norway to participate in the EU's Internal Market without a conventional EU membership. |

## Acronyms and Abbreviations (Cont'd)

| Abbreviation or Acronym | EU | US | Definition |
|---|---|---|---|
| EIOPA | √ | | European Insurance and Occupational Pensions Authority, part of the European System of Financial Supervision consisting of three European Supervisory Authorities and the European Systemic Risk Board, independent advisory body to the EC, the European Parliament and the Council of the EU |
| EIOPA Regulation | √ | | Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC |
| ERM | √ | √ | Enterprise Risk Management, a framework for risk management across an entire enterprise, including all entities within a group, and addressing all material risks. |
| ESRB | √ | | European Systemic Risk Board, is responsible for the macro-prudential oversight of the financial system within the EU in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU |
| FRSAC | | √ | Financial Regulation Standards and Accreditation (F) Committee of the NAIC, which oversees the NAIC's Accreditation Program |
| FACI | | √ | Federal Advisory Committee on Insurance, a body that provides advice and recommendations to the FIO to assist the FIO in carrying out its duties and authorities. |
| FAWG | | √ | Financial Analysis Working Group of the NAIC, which performs analyses of nationally-significant insurers and operates as a peer review mechanism for state insurance regulators in the U.S. |
| FDIC | | √ | Federal Deposit Insurance Corporation, a U.S. governmental agency that preserves and promotes public confidence in the U.S. financial regime by insuring depositors up to certain amounts, by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial regime when a bank or thrift institution fails |
| FRB | | √ | Federal Reserve Board of Governors, the central bank of the United States |

## Acronyms and Abbreviations (Cont'd)

| Abbreviation or Acronym | EU | US | Definition |
|---|---|---|---|
| FICOD | √ | | Financial Conglomerates Directive: Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council |
| FIO | | √ | Federal Insurance Office, which was created by the Dodd-Frank Act as part of the U.S. Department of the Treasury to, among other things, monitor all aspects of the insurance industry, coordinate and develop Federal policy on prudential aspects of international insurance matters, including representing the United States, as appropriate, in the International Association of Insurance Supervisors |
| FOI | | √ | Freedom of information laws in the U.S. concerning government records and actions which are premised on public access to official actions |
| SRP Guidelines | √ | | Proposed guidance that is under consultation in the EU pertaining to the supervisory review process |
| Handbook | | √ | Financial Condition Examiners Handbook of the NAIC |
| IGT | √ | √ | Intra-group transaction, i.e., a transaction between two or more related parties within a corporate group |
| IHC Model Act | | √ | NAIC Insurance Holding Company System Regulatory Act and accompanying regulation (No. 440 and 450) |
| ISA | √ | √ | International Standards on Auditing, issued by the International Auditing and Assurance Standards Board |
| MCL | | √ | Mandatory Control Level, an RBC-based regulatory action threshold used in the state-based regime in the U.S. |
| MCR | √ | | Minimum Capital Requirement, part of the prudential regulatory regime in the EU; a minimum level of security below which the amount of financial resources should not fall. |
| MD&A | | √ | Management's Discussion & Analysis, a narrative that is part of the Annual Statement which is filed by insurers with state insurance regulators in the U.S., as well as in financial reports (Form 10-K) filed by publicly-held companies with the SEC |
| MoU | √ | √ | Memorandum of Understanding |
| NAIC | | √ | National Association of Insurance Commissioners, a standard-setting and regulatory support organization to state insurance regulators in the U.S. |

## Acronyms and Abbreviations (Cont'd)

| Abbreviation or Acronym | EU | US | Definition |
|---|---|---|---|
| ORSA | √ | √ | Own Risk and Solvency Assessment; the processes and procedures used to identify, assess, monitor, manage, and report the short and long term risks a (re)insurance company or group faces or may face and to determine their capital adequacy ("prospective solvency assessment") from the company-own perspective |
| QRT | √ | | Quantitative Reporting Template, a financial report form that is used by insurers for filing financial information on a quarterly basis with a national supervisory authority in the EU |
| RAL | | √ | Regulatory Action Level, an RBC-based regulatory action threshold in the state-based regime in the U.S. |
| RBC | | √ | Risk-based capital, the basis for capital requirements for insurers in the U.S. and which sets thresholds to prompt regulatory action |
| SEC | | √ | Securities and Exchange Commission, a federal agency in the U.S. that is the primary overseer and regulator of the U.S. securities markets |
| SCR | √ | | Solvency Capital Requirement, part of the prudential regulatory regime in the EU; a risk-sensitive capital requirement which is based on a prospective calculation and intended to trigger appropriate and timely intervention by supervisory authorities |
| SFCR | √ | | Solvency and Financial Condition Report, a financial report form that is used by insurers for filing financial information on an annual basis with a National Supervisory Authority in the EU |
| SLHC | | √ | Savings & Loan Holding Company, a holding company whose entire corporate group is subject to consolidated supervision in the U.S. by the Federal Reserve by virtue of its ownership of a savings & loan |
| Solvency II Directive | √ | | Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) |
| SPV | √ | √ | Special Purpose Vehicle |
| SPRV | √ | √ | Special Purpose Reinsurance Vehicle |
| SPRV Model Act | | | NAIC's Special Purpose Reinsurance Vehicles Model Act (#789) |
| TAC | | √ | Total Adjusted Capital |
| TC | √ | √ | Technical Committee, refers to one of seven such committees that worked to facilitate mutual understanding of the characteristics and specificities of the insurance regulatory regimes in the EU and in the U.S. which is the subject matter of this report |

## Appendix II – Contributing Parties

The Steering Committee acknowledges the contributions of all who participated on one or more Technical Committees and in preparing the material which is the basis for this report. Those individuals are listed below along with their state/Member State/ or organization affiliation.

| | |
|---|---|
| Julian Adams | United Kingdom, FSA |
| Thorsten Arhold | Germany, BaFin |
| John Bauer | NAIC |
| Marius Berchem | Germany, BaFin |
| Mike Boerner | Texas, USA |
| Al Bottalico | California, USA |
| Larry Bruning | NAIC |
| Paolo Cadoni | United Kingdom, FSA |
| Elena Barra Caracciolo | Italy, ISVAP |
| John Connolly | FIO |
| Michael Consedine | Pennsylvania, USA |
| Ryan Couch | NAIC |
| Kris DeFrain | NAIC |
| Dan Daveline | NAIC |
| Randall Dodd | FIO |
| Dessislava Doncheva | EIOPA |
| Petra Faber-Graw | Germany, BaFin |
| Lou Felice | NAIC |
| Tom Finnell | FIO |
| Ed Forshaw | United Kingdom, FSA |
| Julie Gann | NAIC |
| Julie Glaszczak | NAIC |
| Axelle Gokkoyun | France, ACP |
| Sandra Hack | EIOPA |
| Sejal Haria | United Kingdom, FSA |
| Petra Hielkema | Netherlands, DNB |
| Dora Iltcheva | EIOPA |
| Bruce Jenson | NAIC |
| Steve Johnson | Pennsylvania, USA |
| Jeff Johnston | NAIC |
| Nichola Joly | France, ACP |
| Christian Kerfriden | United Kingdom, FSA |

| | |
|---|---|
| Jane Koenigsman | NAIC |
| Iwona Krasniewska | EIOPA |
| Matt McKenney | FIO |
| Peter Medley | Wisconsin, USA |
| Ana Teresa Moutinho | EIOPA |
| Simona Murariu | EIOPA |
| Christine Neighbors | Nebraska, USA |
| John Nolan | FIO |
| Charlotte Paterson | EC |
| Richard Piazza | Louisiana, USA |
| José Pinto de Sa | Portugal, ISP |
| David Revelin | France, ACP |
| Fiona Rogers | United Kingdom, FSA |
| Danny Saenz | Texas, USA |
| Daniel Schelp | NAIC |
| Todd Sells | NAIC |
| Jonathan Sepanski | United Kingdom, FSA |
| Bartholomaeus Skrobis | Germany, BaFin |
| David Smith | Virginia, USA |
| Doug Stolte | Virginia, USA |
| Francois Tempe | France, ACP |
| Eric Thompson | NAIC |
| Gita Timmerman | NAIC |
| Olivier Trecco | France, ACP |
| Christina Urias | Arizona, USA |
| Marieke van Grevenstein | EIOPA |
| Thijs van Woerden | Netherlands, DNB |
| Elzbieta Woynowska | United Kingdom, FSA |
| Sheikh Yasir | United Kingdom, FSA |
| Manuela Zweimueller | EIOPA |