



LATF regulatory update

By Jacqueline Yang, FSA, MAAA and Laura Gray, FSA, MAAA

This article provides an update of significant regulatory topics that the NAIC's Life Actuarial Task Force (LATF) has been addressing in the life insurance and annuities arenas.

Life Insurance

The two primary life insurance issues currently being discussed by LATF are Actuarial Guideline XXXVIII (AG 38)¹ as applied to Universal Life products with secondary guarantees and the further development of Valuation Manual 20² (VM 20) which defines the principles based approach (PBA) for life reserving.

AG 38 and Universal Life products with secondary guarantees (ULSG)

Background

In recent years, several companies have developed Universal Life with secondary guarantee products. Some of these products, sometimes referred to as Term UL, are marketed and illustrated as direct alternatives to traditional term products because they can have no to very low cash value buildup and offer premium levels that are competitive with term business. Several of these Term UL products have shadow

accounts incorporating varying tiers of policy charges (e.g., COI charges) or credited rates. In some instances, these charges vary based on whether the shadow account has a positive value or not. By using the higher tier policy charges, a higher minimum gross premium becomes applicable for valuation purposes. The effect of the higher premium is to create lower deficiency reserves. This effect may be exacerbated if the higher policy charges apply only when the shadow account is zero or less, resulting from a practice of calculating the minimum valuation premiums based on the amount of premium needed to carry the account value from zero at the beginning of the policy year to zero at the end of the policy year (the "zero-to-zero" approach).

There is discussion among regulators that the use of the higher policy charges is being used as a mechanism to lower reserves below the level intended by the NAIC Valuation of Life Insurance Policies Model Regulation³ and AG 38. The point of contention appears to be the use of the "zero-to-zero" approach for the derivation of minimum gross premiums in the determination of deficiency reserves.

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¹ Actuarial Guideline XXXVIII as published in the NAIC Examiner's handbook applies to policies and certificates issued on or after the later of the date of a state's adoption of the revised Model and January 1, 2003.

² Valuation Manual as being developed by the NAIC for the minimum reserve and related requirements pursuant to the Standard Valuation Law. Requirements in the Valuation Manual are applicable to all life, annuity, deposit-type contracts, and health insurance business as provided in the Valuation Manual.

³ Valuation of Life Insurance Policies Model Regulation published by the NAIC, effective January 1, 2000 but subject to state-by-state adoption basis.

Time line

This issue was first raised in late 2010, although these products (ULSG with multiple shadow fund structures) have been in the market for several years.

- November 2010–January 2011 – The New York State Department of Financial Services formerly known as the “New York Insurance Department” sent formal requests to some companies (although discussions took place earlier) for information on the number of ULSG policies, resulting reserves, and sample reserve calculations on individual policies. There were several meetings held between New York and these companies. The issue was eventually deferred until the second half of 2011.
- March 2011 – At the NAIC Spring LATF meeting, a motion was set forth to draft a letter to the Actuarial Board for Counseling and Discipline (ABCD) on the professional responsibilities of the actuaries involved. A second motion was proposed to draft a bulletin to all insurance departments to clarify the application of AG 38. No vote was taken on either motion.
- April to August 2011 – A subcommittee of LATF met in private almost weekly to discuss the issue. The result was an Exposure Draft to be presented to the larger committee and interested parties.
- August 30, 2011 – The LATF subcommittee had its first public meeting on the matter. It voted on the first motion presented at the March 2011 Spring Meeting not to pursue any further action on the ABCD item. During discussions with the ABCD, it was determined

that the discipline process would be more appropriately left to the state insurance departments and not with LATF. The second March motion proposing a bulletin be developed and sent to the Insurance Commissioners was also put to a vote and passed.

- September 8, 2011 – The LATF subcommittee exposed the draft Statement on Actuarial Guideline XXXVIII. After much discussion, a motion was approved to release the draft Statement for comment to other regulators, industry, and interested parties with a 45-day comment period preceding the Fall NAIC meeting. The draft Statement can be found at the following link: http://www.naic.org/documents/committees_a_latf_exposures_ag38_110908.pdf. A release of the comment letters on the AG 38 Statement draft can be found at: http://www.naic.org/documents/committees_a_latf_111101_ag38_letters.pdf. The majority of the letters from the industry indicated that the Statement draft should be rejected. While some parties argued in favor of having the Statement be prospective in nature only (and relying on the stand-alone Asset Adequacy Testing in AG 38 for evaluating currently in-force business), the final passing version of the Statement did not specify that it would apply prospectively only.
- November 2011 – The NAIC Fall meeting took up the issue again and LATF heard from companies and industry groups who had provided comment letters on the issue. After extended discussions,

the LATF voted to adopt the proposed Statement on AG 38 with slight modifications. These modifications were intended to keep the focus on those products with multiple (i.e., higher) policy charges that apply only when the shadow account is at or below zero and to prevent other policies that also use the “zero-to-zero” approach for calculating the minimum gross premium from being swept in to the Statement. The Life Insurance and Annuities (A) Committee, which is the parent committee of LATF, voted to receive (not a vote to accept) the Statement and agreed to form a joint working group with the Financial Condition (E) Committee to study the issue further and develop additional guidance as needed.

- December 2011 – The NAIC Joint Working Group of the Life Insurance and Annuities (A) Committee and the Financial Condition (E) Committee held its first public meeting to provide information on the purpose of the committee. They hired an external attorney to gather responses from members of LATF, other insurance commissioners, and interested parties to understand different viewpoints, agreements, and disagreements. The process will be bifurcated into two approaches affecting in-force business and new business. The committee will be developing the framework for a solution.

The following article, “Actuarial Guideline 38 – An actuarial discussion point”, by Joe Rafson and Shelly-Ann Harper discusses the reserving aspects in more detail.



Valuation Manual 20 (VM 20) Impact Study

VM 20 describes the established minimum reserve valuation standard for individual life insurance policies using a principles-based reserve valuation with a net premium reserve floor under the Standard Valuation Law. Current revisions approved into the current draft of VM 20 include providing additional wording on the certification process related to requirements to pass the stochastic exclusion test.

While the development of VM 20 is meant to be a move towards principles-based reserving, it currently includes a net premium reserve floor. Industry had expressed concerns regarding the direction of VM 20, moving from a pure principles-based approach to being too prescriptive. In order to address these concerns, LATF undertook an Impact Study of VM 20 prior to adoption. Based on initial results, the Impact Study has subsequently been expanded to include a second Phase. The Impact Study Phase 1⁴ was focused on methodology, impact of the net premium reserve floor, exclusion tests, and reinsurance. Phase 2⁵ focused on the sensitivities of the two discount rate definitions: Alternative 1 is based on a function of the appropriate U.S. Treasury interest rate plus a spread and Alternative 2 is based on deducting asset default costs and anticipated investment expenses from the gross investment income.

Phase 1 Impact Study

The results of the Phase 1 Impact Study were presented to LATF on August 31, 2011. The results were summarized by the following eight major product lines:

- 10-Year Term (Term 10)
- 20-Year Term (Term 20)
- 30-Year Term (Term 30)
- Aggregate Term (Agg. Term) – includes all Term products for a given company not split by term period

During the study, it was noted that ULSG reserves generally increased; however, clarification is required to determine the AG 38 methodology used and the type of ULSG products to ensure consistency in the comparisons. Term reserves, by product and when aggregated, generally decreased. TWL reserves were the same as CRVM under VM 20, so there was no impact.

Under the Stochastic Reserve Exclusion Test (SRET), ULSG failed, TWL passed, and SIWL, VUL, and Term products showed mixed results. Products often failed if heavily guaranteed or if they had asset/liability mismatches. Under the Deterministic Reserve Exclusion Test (DRET), Term and ULSG failed; Term failed both if tested over the level term period or entire contract period. Meanwhile, TWL, SIWL, and VUL passed the DRET. More work will need to be done to determine why products failed DRET.

During the Impact Study, it was determined that there were sections of VM 20 that were confusing and/or difficult to implement. These items include:

- 1) Mortality assumption setting credibility-blending and margin setting process was determined to be difficult to follow and implement.
- 2) Implementing the Prescribed Default Cost methodology was difficult.
- 3) Modeling asset values was difficult under the Alternative 1 discount rate approach.
- 4) SRET appears to break down when significant amounts of reinsurance exist because the test statistic can produce extreme results with a small denominator.

- 5) Determination of explicit margins for each assumption vs. having an aggregate margin.
- 6) DRET did not specifically address how to apply the test statistic; i.e., if the definition should be based on the sum or the present value of valuation net and guaranteed gross premiums.
- 7) It was difficult to iteratively create a starting asset value to meet the 98 percent/102 percent of the final aggregate modeled reserve.

Phase 2 Impact Study

The preliminary results of Phase 2 Impact Study were presented to LATF on September 29, 2011; however, study results still could be submitted up to October 14. Phase 2 focused on the sensitivity of the discount rate assumption (Alternative 1 and 2) under different interest rate scenarios. A final report will be drafted and submitted to LATF.

Outstanding items

During the review of the first Impact Study, there was discussion on proposed suggestions to bifurcate the scope of VM 20 to apply it first to Term/ULSG and then all other product lines. There was also discussion about the decision on the definition of the discount rate assumption (Alternative 1 vs. 2) and the use and definitions of credibility and mortality segments.

During a recent LATF subgroup call on December 15, 2011, the committee indicated that there was a goal to adopt VM 20 in time for the March 2012 NAIC meeting to be ready for legislative action in 2013. The committee will attempt to resolve key issues relating to reinvestment spreads, difficulties in calculating the net premium reserve, credibility blending, and margins.

⁴ Phase 1 Impact Study presented to LATF on August 31, 2011 and updated September 14, 2011 by Towers Watson.

⁵ Phase 2 Impact Study presented to LATF on October 6, 2011.

Annuities

A current item on the LATF's agenda is the development of a new payout annuity table by the joint American Academy of Actuaries/Society of Actuaries Payout Annuity Table Team, a subgroup of the Life Experience Subcommittee. The new 2012 Individual Annuity Reserving (IAR) Table is a generational mortality table created based on improvement factors and the 2012 Individual Annuity Mortality Basic Table (2012 IAM Basic Table) and is not a static table.

Having a generational table could cause difficulty for product actuaries who would potentially need to make decisions

on the effect of the generational table on product pricing. This would also impact the statutory and tax valuation systems which would have different mortality rates for each issue year (2012 and subsequent).

A report from the joint American Academy of Actuaries/Society of Actuaries Payout Annuity Table Team on the 2012 Individual Annuity Reserving (IAR) Table was presented to LATF on October 4, 2011 and was released for comment. Comments on the 2012 IAR have been requested to be received by April 6, 2012.

The report can be found at the following link: http://www.naic.org/documents/committees_lhatf_exposure_2012_ind_ann_res_tbl.pdf.

A request to amend the "NAIC Model Rule (Regulation) for Recognizing a New Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities (#821)" has also been sent to the Life Insurance and Annuities (A) Committee and Executive Committee as required as part of the NAIC process.



Actuarial Guideline 38 – An actuarial discussion point

By Joe Rafson, FSA, MAAA, CFA and Shelly-Ann Harper

Introduction

Over the past eight years, Universal Life (UL) policy designs have reflected increased use of no-lapse guarantees. In particular, Universal Life policies with Secondary Guarantees (ULSG) with multiple shadow account structures have grown in use and prominence in company product portfolios. A large part of the product's popularity derives from their being sold as a term-like alternative, with guarantees embedded in the products being featured. In order to keep consumer prices low and combinations of Cost of Insurance (COI) and crediting rates attractive, some companies have applied an interpretation of Actuarial Guideline XXXVIII (The Application of the Valuation of Life Insurance Policies Model Regulation or AG 38). The NAIC, through a sub committee of the Life Actuarial Task Force (LATF), has questioned this reserving practice. A change to companies' application of AG 38 would affect not only their current balance sheets, but may also impact the product suites available in the marketplace.

Issue

The ULSG product designs in question have some variations, but a typical design would stipulate that if the shadow account is positive, a more liberal COI and crediting rate combination is applied. If the shadow fund goes to zero, a lower crediting rate and higher charges are applied. Many companies are determining the minimum premium used for setting reserves using a provision in AG 38, section 98.7(a)(8)(2)(ii) which reads:

"The 'minimum premium' for purposes of this paragraph means the premium which if paid into a policy with a zero account value at the beginning of the policy year, would produce a zero account value at the end of that policy year assuming the guaranteed mortality and expense charges are assessed and assuming



the guaranteed interest rate is credited. The minimum premiums for all policy years are calculated at issue..."

Regulators have raised the issue that if a policy shadow fund were only one penny higher, a more generous combination of COIs and crediting rates would be guaranteed and applied. They point to section 8c of AG 38: "First, the minimum gross premiums (determined at issue) that will satisfy the secondary guarantee requirement must be derived." They argue that the product reserving which only applies guarantees based on a zero account value is not in compliance with AG 38 or NY 147 (New York's version of AG 38) when there are more generous benefits not being valued. Further, they point to the introduction of AG 38 to support their position: "Obviously, new policy designs will emerge subsequent to the development of this document. No statute, regulation, or guideline can anticipate every future product design, and common sense and professional responsibility are needed to assure compliance with both the

letter and the spirit of the law. While the Model is a complex regulation, its intent is clear: reserves need to be established for the guarantees provided by a policy. Policy designs which are created to simply disguise those guarantees or exploit a perceived loophole must be reserved in a manner similar to more typical designs with similar guarantees."

Example

In this section, we look at an example of the effect of the interpretation of the guideline on the reserve for an individual policy. The example was specifically designed to demonstrate the effect of the multiple COI feature on the reserves.

The policyholder is assumed to be female, age 67, and nonsmoker. She was issued a UL policy with shadow account with two COI schedules in October 2007 and has a face amount of 500,000 and an account value of 1,180. Reserves are calculated using a valuation date of December 2008 with a 2001 CSO mortality table and a valuation interest rate of 4.0 percent. See Exhibit 1 for a graphical representation/quantification of this issue.

The YRT Premium 2 is based on the higher COI, which is only charged to policies with shadow funds equal to zero. The lower scale, YRT Premium 1, applies to most policies with a shadow fund greater than \$0.01. Larger deficiency reserves can be generated depending on the amount by which the amount that the YRT Premium scale 1 is below the net valuation premium line. The present value of all these differences is a deficiency reserve to be held per the NYID and the Exposure Draft from LATF.

According to the zero-to-zero interpretation, the COI 2 charge applies in all policy years. After the first policy year, only if the prior year-end shadow account value is less than or equal to zero, do the COI 2 charges apply; otherwise, the COI 1 charges apply. According to LATF's interpretation, the COI 1 charge would be used to determine the minimum premium for the AG 38 calculation. Exhibit 2 shows the resulting reserves for this policy under the two interpretations.

Impact

Given the recent statement from LATF's working group as received by the A committee (see time line in the LATF Regulatory Update above), the reserving practices of companies with the "zero-to-zero" policy design and reserving are being questioned. It is noted that the A committee only received and did not adopt the statement, and statements from LATF are not as binding as regulations or guidelines. It is not clear

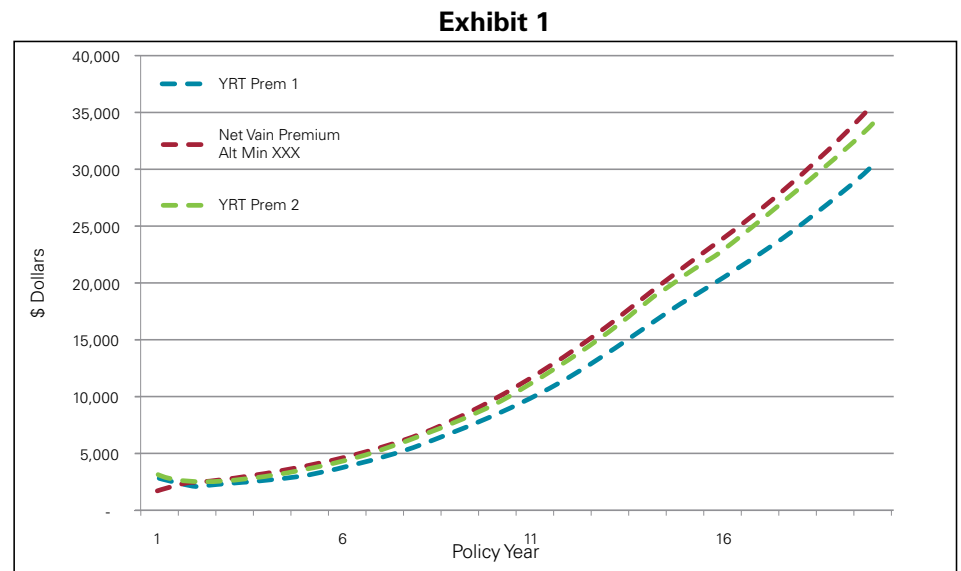


Exhibit 2

	Using higher COI charge	Using lower COI charge
AG 38 basic reserve	2,724	2,868
AG 38 deficiency reserve	9,116	34,375
Total AG 38 reserve	11,840	37,243

how various states will respond to the activity. In any case, the potential impacts of such a change could be significant.

- Total impacts have yet to be quantified but based on indications from affected companies, there could be an increase in total reserves for these products of two to seven times what is currently being held. Deficiency reserves, where this issue affects reserves, would decline over time.

- Products requiring markedly higher reserves may be redesigned or pulled from the market.
- Companies may seek reinsurance or other capital solutions for existing blocks of business, if a combination of block size and capital position warrants the need.

This issue is expected to receive continued attention until a final resolution is reached.



Solvency II update

By Seong-min Eom, FSA, MAAA

Stress test results

In July 2011, The European Insurance and Occupational Pensions Authority (EIOPA) released the results of the second European Insurance Stress Test. The EIOPA announced the second stress test specification in March 2011, which was based on Solvency II. European Union (EU) insurers were asked to test their capital's ability to meet the Solvency II Minimum Capital Requirement (MCR)⁶ under a set of given scenarios.

The objective of this stress test was to understand the resilience, stability, and capital position of EU insurers under severe market conditions. The EIOPA emphasized that the scenarios provided are hypothetical and do not contain any implicit future market predictions. Moreover, the stress test results are not relevant to insurers' capital requirements.

Three scenarios were provided: Baseline, Adverse, and Inflation. The Baseline scenario is already a severe market scenario. The Adverse scenario is a more severe market scenario with shocks in major macroeconomic variables. Finally, the Inflation scenario assumes a significant increase in inflation followed by a rapid interest rate increase. The main risks reflected in the scenarios are market, credit, and insurance risks. In addition, sovereign bond exposure (Sovereign Stress scenario) was measured separately as a supplementary test scenario.

EIOPA had a minimum 50 percent participation goal for this stress test. Approximately 60 percent of insurers in the EU, European Economic Area, and Switzerland participated; 58 groups and 71 individual undertakings reported stress test results from a total of 221 (re) insurers in the territory.



A brief summary of the stress test results is shown below:

Results of the stress test ⁷					
Scenarios	MCR Coverage Ratio	Impact on Capital*	Scenarios	Failing MCR insurers %	Failing insurers Capital Deficit*
Baseline	320%	92	Baseline	9%	2.6
Adverse	281%	150	Adverse	10%	4.4
Inflation	342%	58	Inflation	8%	2.5
Sovereign Stress			Sovereign Stress		

* in EUR billion

⁶The Minimum Capital Requirement (MCR), which represents the minimum level below which the amount of financial resources should not fall, is defined as the potential amount of own funds that would be consumed by unexpected events whose probability of occurrence within a one-year time frame is 15 percent.

⁷ From EIOPA Stress Test 2011 Press Briefing; https://eiopa.europa.eu/fileadmin/tx_dam/files/Press-Room/Stress%20Test%20Results-Presentation.pdf.

The main drivers of the impact on capital from the asset side were adverse movements of equity prices, interest rates, and sovereign bond markets; from the liability side, non-life risks such as natural catastrophic events with limited reinsurance or deficiency of claims reserves caused by claims inflation had a more significant impact on capital.

National supervisors are expected to discuss the results of the stress test with each insurer, and the results will influence the Solvency II implementation plan. Insurers will need to enhance their risk strategies and Solvency II implementation plans to address certain scenarios and vulnerabilities based on the results of the stress test.

The German Insurance Association (GDV) recently announced that there will be a Solvency II Quantitative Impact Study 6 (QIS6) in 2012. This study will not be led by the EIOPA, but independently by the GDV to help German insurers implement the new regime. Belgium also showed an interest in performing a QIS6.

Equivalence

The European Commission may adopt a decision regarding the Solvency II equivalence of third country regimes after a consultation with the European Insurance and Occupational Pensions Committee (EIOPC). Once a decision is made, it will supersede any existing assessments or determinations of the Group Supervisor. A final decision on equivalence is expected to be made during 2012 by the European Commission. Some country-specific information, including insights impacting U.S.-based insurers, is discussed later in this article.

The equivalence status will impact how the group solvency assessment is made, particularly for Third Country (TC) subsidiaries with the parent company headquartered in the European Economic

Area (EEA) or EEA subsidiaries whose parents are in a TC. Generally speaking, for the group located in the EEA with subsidiaries in an equivalent TC, the group solvency assessment is calculated by default in the EU consolidated account with diversification recognized. Subsidiaries in a TC will be treated equally to the EEA subsidiaries.

If the group headquarters is located in the equivalent TC with subsidiaries in EEA, group solvency assessment is mainly supervised by the TC supervisor with an arranged EEA supervisor cooperation.

The tables below provide a detailed description of the current group solvency assessment approach:

Solvency assessment

1. Group headquarter is located in EEA, with TC entities

- The treatment for TC entities should be the same as the treatment for EEA entities

a) Dominant influence

Default Method	Full/Partial integration	Diversification recognized
Alternative Method	Deduction/Aggregation	Diversification not recognized
	• If equivalent	Local Capital Requirement is applied
	• If not equivalent	Solvency II Capital Requirement is applied

b) Significant influence

Default Method	Equity value	Diversification not recognized
	Solvency II Capital Requirement is applied	
Alternative Method	Deduction/Aggregation	Diversification not recognized
	• If equivalent	Local Capital Requirement is applied
	• If not equivalent	Solvency II Capital Requirement is applied

2. Group headquarter is not located in EEA, but in TC

Group Solvency Calculation	• If equivalent	By TC Supervisory authority
		EEA Supervisor cooperative in arranging
	• If not equivalent	At the level of insurance holding company
		TC (re)insurance undertaking
Option	Either consolidation or alternative method	
	Establish an insurance holding company in EEA and apply the group supervision in the level	

Generally speaking, a holding of more than 20 percent of voting rights is categorized as significant influence, while the determination of dominant influence would consider representation on the board of directors, material transactions between the two entities, interchange of managerial personnel, provision of essential technical information, management on a unified basis, etc.

In addition to the **group solvency assessment, reinsurance and group supervision** are the other equivalence status categories to be determined. For the reinsurance category, by achieving an equivalent status, reinsurers can approach the EEA and equivalent TC insurers more easily. Groups whose headquarters are located in the equivalent TCs can maintain that EEA subsidiaries comply with Solvency II and equivalent area subsidiaries comply with their local rules, which can lead the reinsurers to hold less required capital in aggregate.

The EIOPA recently released its initial conclusions on the equivalence status of Bermuda, Switzerland, and Japan. The three countries are the first batch of the TCs that have challenged to get equivalence. As outlined below, none of the three countries achieved complete satisfaction of equivalence.

Switzerland: Equivalent for all three categories. However, some areas were regarded as only partly equivalent. Public disclosure requirements were not as extensive as Solvency II. Furthermore, Swiss insurers need to have more compliance functions as required by Solvency II and an internal audit function. The EIOPA wants to revisit the public disclosure regime again once the Swiss Financial Market Supervisory Authority (FINMA) completes its review.

Bermuda: The Bermuda Monetary Authority (BMA) categorizes insurers into classes and the current equivalence varied by class. Overall, BMA is not fully equivalent, and EIOPA plans to revisit once the BMA valuation methodology and some insurers' reclassification changes are finalized. Some areas, such as authorization of insurers and governance and public disclosure requirements, need to be more extensive to be equivalent.

Japan: The Japanese Financial Services Agency (JFSA) was largely equivalent for its authorization of reinsurance business. As opposed to the general principles in Solvency II, JFSA allows Japanese insurers to have insurance and incidental noninsurance business. Though JFSA closely monitors the business, this brings potential risks. JFSA is largely equivalent in governance and public disclosure requirements. EIOPA requested more reporting requirements to the supervisory authority by internal and external auditors in certain situations and improvements to statutory disclosure requirements. JFSA is partially equivalent in reinsurance solvency due to reserves; the required reserves amount is not considered risk-based and is not calculated using market consistent valuation. Once the JFSA finalizes the market consistent valuation of liabilities, reinsurance is expected to reach a largely equivalent status.

For some nonequivalent TCs that need more time to develop and implement an equivalent solvency system, transitional arrangements will be applied to treat the countries' temporary equivalence. Omnibus II will describe the treatment of equivalence with transitional measures and periods.

The European Commission (The Commission) released its Omnibus II Directive proposal. In response, the Presidency Council of European Union (The Council) made proposal drafts for Omnibus II amendments in June and September 2011, and another amendment proposal draft by the Committee on Economic and Monetary Affairs (ECON) of the European Parliament (The Parliament) was published in July 2011.

The Parliament proposal draft provided more detailed transitional measure requirements for Group Solvency Calculation, Group Supervisions, Reinsurance, Tier 1 and Tier 2 Basic Own-funds, and Treatment of Third-country supervision. The proposal draft from The Council introduced transitions in areas such as the Discount Rate, Treatment of Run-off Insurers, Currency Treatment, and Equity-risk Capital, which the Parliament did not touch on.

- The Parliament suggested reviewing TC (re)insurers regularly for transparency purposes, updating their equivalence status and the list of equivalent countries (which is made public).
- The risk-free discount rate as proposed by The Council is described below:
 - The specifications, updates, and technical information will be published and carried by EIOPA.
 - The rates from the risk-free term structure will be used to calculate the best estimate liabilities.
 - During transition, a weighted average approach of asset yields and risk-free rates will be used where the risk-free rate component increases from 0 percent to 100 percent on at least a linear basis during the seven-year transitional period.

United States: The United States was not included in the initial equivalence assessment. Currently, the National Association of Insurance Commissioners (NAIC) is developing the Solvency Modernization Initiative (SMI) which includes Group Supervision, one of three components for the Solvency II equivalence assessment within an Own Risk and Solvency Assessment (ORSA). The EIOPA will defer the comprehensive equivalence assessment until the SMI is finalized.

There are a few concerns in assessing U.S. Solvency II Equivalence. There is no central authority that controls and supervises U.S. insurance companies. Recently, the Federal Insurance Office (FIO) was created within the U.S. Department of Treasury under the Dodd-Frank Wall Street Reform and Consumer Protection Act. This marks a significant change for the U.S. insurance industry because insurers had previously only been supervised at an individual state level. Still, the FIO does not have general supervisory or regulatory authority over insurance companies. Those functions will be kept under state regulators. Instead, the FIO is expected to advise on major domestic or international issues and represent the United States in communicating with other relevant international organizations. The NAIC is a central coordinating

organization for U.S. insurance policy and regulation development. However, the NAIC does not have formal authority and does not supervise insurers. For the Solvency II equivalence assessment, EIOPA needs to find a way to make an agreement with all the states collectively rather than negotiating with each state individually.

While the United States was not included in the Solvency II equivalence assessment's first wave, political will may lead to an arrangement for the United States to be treated as equivalent for a given period of years until the U.S. regime is officially assessed for Solvency II equivalence. The implementation of Solvency II in the EU will have a significant impact on U.S. insurers. The first direct impact will be on the subsidiaries of European insurance group. By achieving equivalence they can be saved from preparing two separate reports for the EU and the United States. U.S.-based insurers who have business in the EU region can benefit from not needing to comply with the Solvency II Group Solvency Reporting requirements. In addition to the reporting aspect, achieving equivalence can give U.S. companies opportunities to develop products that require less capital or less strict Solvency II Group Solvency/Group Supervision guidelines under U.S. regulation than European competitors.

Solvency II time line

One of the latest major announcements, though somewhat expected, for Solvency II implementation is a possible delay of the Solvency II effective date. Amendment proposals for Omnibus II from The Council and The Parliament proposed delaying Solvency II's effective date from January 1, 2013 to January 1, 2014 due to concerns on the level of readiness for some insurers or states.

The Omnibus II Directives are intended to amend the Solvency II Directives. The major areas that Omnibus II will cover are Solvency II effective date and relevant time lines, transitional measure for equivalence, and technical amendments.

The drafts published by The Council and The Parliament are still their own drafts. First, each of them needs to finalize their proposal internally to decide their own position for Solvency II and publish their official Omnibus II proposal. Then The Council, The Parliament, and The Commission will debate and try to find an agreement for approval. These procedures are expected to be completed by the end of 2011.

Currently, the European Parliament Omnibus II vote is scheduled for January or February 2012 and will be published in the European Union Official Journal in March/April 2012. By publishing official Omnibus II Directives, the Solvency II effective date, transitional measures for equivalence, and transitional periods will be declared. The insurance industry wants to have certainty around the implementation date and transitional measures as soon as possible.

Many insurers have invested heavily in time and resources preparing for Solvency II. They have tried to put in place a risk management culture with extensive documentation. Companies wanting to use the internal model approach enhanced their own models in the hopes of receiving approval. Companies that were less prepared for Solvency II might feel relieved by the news that the implementation date could be delayed. Still, insurers should not lose momentum in their implementation efforts.

The implementation date is approaching and, according to the proposal drafts, insurers need to prepare Solvency II implementation plans and progress reports to submit to national supervisors by the middle of 2013. The delay of the dates might also lead supervisors to expect higher level of achievement from insurers and closer engagement with supervisors. Many insurers are looking at a potential delay in the implementation date as a measure of relief for implementation efforts but few have relaxed internal timetables. All companies, not just directly impacted companies, should continue to monitor developments around Solvency II and related initiatives.



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KPMG's Life Actuarial Services practice

KPMG's Life Actuarial is a national practice that offers a wide array of services provided by highly qualified professionals. Our services include:

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 - Audit Services
 - Reserve Review and Analyses
 - Internal Audit Services
 - Accounting Advisory Services Support
- Transforming Actuarial Organizations:
 - Global Financial Statement Conversion Services
 - Quality Close/Actuarial Process Improvements
 - Project Management Services
- Model Services:
 - Actuarial Modeling
 - Model Risk and Control
 - Model Validation Services
 - Systems Conversion Support
- Risk and Capital:
 - Risk and Capital Management
 - Transaction Services
- Compliance and Controls:
 - Internal Controls Review
 - Sarbanes-Oxley 404 Compliance Assistance
 - Regulatory Compliance Practice

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