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**...March 1-4, 2009, Four Seasons, Las Vegas, NV**

*A Global Gathering for Senior Life Insurance and Reinsurance Executives*

**ReFocus 2009**

**March 1-4, 2009**

**Las Vegas, NV**

**B4 – The Future of Reinsurance Regulation**

**David Gates, Donald Henderson, Howard Mills**

**Hugh McCormick**

**Moderator**



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## The Future of Reinsurance Regulation

Hugh T. McCormick  
David Gates  
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# “PBR

The Once and Future Hope

# ”

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## Disclaimer

- I am an Attorney
- I am not an Actuary
- I do not play an Actuary on TV
- The bulk of my presentation has been “liberated” from other sources (...people who actually know something about this...)
  - The presentation has been changed to protect the innocent

## Principle Based Reserves (PBR) - Background

- What is it?
  - Effort to modernize reserve requirements focusing on the use of principles as opposed to formulaic structures
- Approach
  - Identify policies’ material risks, benefits and guarantees
  - Use risk analysis and risk management techniques to quantify risk (e.g., modeling, company specific assumptions)
  - Updated annually
  - High degree of interaction with regulators

## PBR - Roots

- Initial Impetus
  - Inability to properly set reserves for variable annuity guarantees
  - VA CARVM
- Additional Problems
  - AG-38 ( $X^3$ ,  $AX^3$ )
- Proponents
  - American Academy of Actuaries
  - American Counsel of Life Insurers

## PBR – American Academy of Actuaries

- Academy reaches conclusion that formulaic reserving structure is archaic and no longer meets industry needs
- Academy develops concept of PBR
- Academy working groups develop high level framework/principles
- Academy presents PBR concept to NAIC (12/2005)

## Academy & NAIC

- Academy Working Groups tasked with “fleshing out” PBR proposal
- NAIC
  - Life & Health Actuarial TF (LHATF) focal point for vetting Academy WG’s proposals
  - NAIC comes to agree that life reserving system needs upgrading (~ ‘07)
  - NAIC ramps up PBR efforts (‘08)

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## PRB - Implementation

- Revised “Standard Valuation Law” will be “enabling” statute
- A new “Valuation Manual” will be developed
  - Manual will contain detailed instructions, principles and procedures to be applied
  - Manual will operate/be updated much like the APPM

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## PBR - Issues

- Tax treatment
  - IRS Notice 2008-18 (Net Premium Calc)
- Ability of Companies to “upgrade” their actuarial systems and staff to handle new approach
- Ability of states to manage PBR system

## PBR – Vignettes: Risk Transfer

- Conditions for Risk Transfer
  - NAIC Life & Health Reinsurance Agreements Model Regulation
  - SSAP 61 & A-791
- Academy Proposal
  - Eliminate Restriction
- LHATF
  - Rejected proposal, in part
  - Looking at possibly relaxing requirement in specific instances

## Capital Markets Crisis

- How will capital markets crisis impact PBR efforts?
  - Firm up belief that current system “...isn’t broken so stop trying to fix it...”
  - “Technical Impairments” may occur (i.e., companies that cannot meet current regulatory reserve requirements but can meet economic cash flow needs)

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## Current Reinsurance Regulatory Scheme

### Means of Obtaining Credit for Reinsurance

- Reinsurer is licensed in state of domicile of the cedent
- Reinsurer is accredited reinsurer in state of domicile of the cedent
- Reinsurers not licensed or accredited are generally required to post security
- 50-state system – each state regulates its domiciliary cedents
- New York is extraterritorial

## Current Reinsurance Regulatory Scheme

### Unlicensed and Unaccredited Reinsurers - Acceptable Security

- Withheld funds
- Trust fund held by a qualified U.S. financial institution
- Letters of credit issued by a qualified U.S. financial institution

## Reinsurance Regulatory Modernization Framework Proposal

### Key Provisions

- Optional system
- Creates Reinsurance Supervision Review Department (“RSRD”)
- “Home State” for U.S. “National Reinsurers”
- “Port of Entry State” for non-U.S. reinsurers
- Calibrated collateral requirements – prospective only
- Initially for non-life reinsurers only
- Federal enabling legislation

## Reinsurance Supervision Review Department

- New office of the NAIC
- To review and evaluate regulatory systems of U.S states and foreign countries
- To determine whether systems are equivalent in terms of effectiveness to typical U.S. regulation

## RSRD Approval

- International reinsurers domiciled in an RSRD-approved jurisdiction would be eligible to participate in the framework
- Same for U.S. reinsurers
- International reinsurers would select a single Port of Entry (“POE”) state
- U.S. reinsurers would need to be licensed and domiciled in an RSRD-approved “home state”
- Reinsurers would be required to have a minimum capital and surplus of \$250 million

## International Reinsurers

- POE state would set standards that the reinsurer would need to meet
- Standards would include level of collateral under the framework
- All other U.S. regulators bound by decision of POE state regarding qualification of reinsurer
- Anticipated that POE state would work with non-U.S. regulator on supervision of reinsurer
- All states required to grant credit for reinsurance ceded by domestic insurers to the reinsurer
- States of domicile of cedents still determine risk transfer issues

## U.S. Reinsurers

- Reinsurers licensed and domiciled in a qualified home state would be known as a “national reinsurer”
- All states required to grant credit for reinsurance ceded by domestic insurers to a national reinsurer
- States of domicile of cedents still determine risk transfer issues

## Security Ratings

- Reinsurers would be assigned one of five security ratings by POE or home state
- Ratings range from Secure -1 to Vulnerable -5
- Rating based on a number of factors, including rating agency ratings
- Rating cannot be higher than rating agency factor

## Proposed New Collateral Requirements

Ratings	% Collateral	Best	S&P
Secure-1	0	A++	AAA
Secure-2	10%	A+	AA+, AA, AA-
Secure-3	20%	A, A-	A+, A, A-
Secure-4	75%	B++, B+	BBB+, BBB, BBB-
Secure-5	100%	B, B-C++, C+ or below	BB+, BB, BB- or below

- For U.S. reinsurers only those rated Secure 4 or 5 are subject to collateral requirements because of “robust” nature of U.S. regulation
- No collateral required for CAT losses for one year
- Framework available only for new reinsurance contracts

## Open Issues

- Different treatment of U.S. and non-U.S. reinsurers
  - to be revisited within 2 years
- Will port of entry state require “registration” or “regulation” of non-U.S. reinsurers
  - acceptance of IFRS (with reconciliation of equity and net income to U.S. GAAP)
- Role of ceding insurer’s regulator
- Continued criticism of rating agencies

## Life Reinsurance

- Framework not available to life reinsurers until earlier of:
  - 24 months after implementation of proposal, or
  - Implementation of U.S. principles-based reserving for life insurance

## Next Steps

- Executive Committee/Plenary approved Framework at December NAIC
- Drafting of Federal enabling legislation
- Adoption by the Congress, President signs into law
- Reinsurers seek qualification



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## Regulation trends

Howard Mills, Director and Chief Advisor  
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## Regulation trends: Overview

- Changing regulatory landscape (re-regulation)
- Likelihood of Federal oversight in some form
- Managing complexities of regulatory changes (i.e. Model Audit Rule, IFRS, Principle Based Reserving)
- Renewed focus on risk and establishing an enterprise-wide framework for managing risk (rating agencies evaluating strength of ERM framework)
- Regulatory requirements bring increased scrutiny to governance, information security and reporting processes

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## Regulation Trends: Principles-based reserving

- NAIC background
  - Under consideration at NAIC for 5+ years
  - Impetus has been increased global competition, complexity of products
- NAIC recent action
  - Fall 2008 adopted VACARVM, first step toward PBR
- NAIC what's ahead
  - 2009 adoption of Valuation Manual
  - Adoption PBR for life reserves by states 2010-2012
  - Timing of Solvency II critical to U.S. competitive advantage

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## U.S. Regulation trends: Reinsurance

- After years of debate, NAIC adopts reinsurance modernization
  - The proposal creates two new classes of reinsurer
  - Collateral rules to change
- On Capitol Hill in 2009
  - Status of the Reinsurance International Solvency Standards Evaluation Board Act
  - Will Congress grant enabling legislation to allow NAIC reinsurance framework?

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## Global Regulation Trends: Reinsurance

- Reinsurers face multitude of regulators globally
  - Licensing and capital requirements differ
  - Adds cost, decreases ability to innovate
- On a global scale, IAIS/regulators are taking notice
- Global regulatory push for more uniform treatment of financial services, including reinsurance

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