

NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
INTERNATIONAL INSURANCE ISSUES COMMITTEE
DUCK KEY, FLORIDA
NOVEMBER 21, 2008
MINUTES

The National Conference of Insurance Legislators (NCOIL) International Insurance Issues Committee met at the Marriott Marquis in New York City on Friday, November 21, 2008, at 11:45 p.m.

Rep. Frank Wald of North Dakota, co-chair of the Committee, presided.

Other members of the Committee present were:

- Sen. Joseph Crisco, CT
- Sen. Vi Simpson, IN
- Rep. Dennis Keene, KY
- Rep. George Keiser, ND
- Sen. Carroll Leavell, NM
- Del. Harry Keith White, WV

Other legislators present were:

- Rep. Kurt Olson, AK
- Rep. Greg Wren, AL
- Rep. Arnold Simpson, KY
- Rep. Don Flanders, NH
- Rep. Charles Curtiss, TN
- Sen. Steve Southerland, TN
- Rep. Gini Milkey, VT

Also in attendance were:

- Susan Nolan, NCOIL Executive Director
- Candace Thorson, NCOIL Deputy Executive Director

MINUTES

After a motion made and seconded, the Committee voted unanimously to approve the minutes of its meeting on July 11, 2008, in New York City.

UK AND EU REGULATORY DEVELOPMENTS

Susan Voss of the Iowa Insurance Department, representing the National Association of Insurance Commissioners (NAIC), said the NAIC was discussing with the EU how to meld their regulatory systems and that reinsurance collateral was one challenge. She said that while the U.S. focuses both on consumer protection and on solvency, the European approach is more solvency-centered.

Commissioner Voss said that Solvency II is a top priority of the International Association of Insurance Supervisors (IAIS) and that the NAIC is dialoging with Europeans and the U.K. regarding its concerns. Among other things, she said, the NAIC had expressed concern over the impact that Solvency II would have on U.S. markets, as well as over whether adoption of Solvency II requirements would “make sense” in today’s global financial crisis.

Commissioner Voss also said that the NAIC was continuing its Memorandum of Understanding (MOU) efforts, which she said help the organization exchange confidential information with other countries.

Rep. Wald asked whether European insurers had been involved with troublesome financial products and, if so, what impact they had had on company financial strength. Doug Barnert of Barnert Associates, representing the Group of North American Insurance Enterprises (GNAIE), said that some international companies were affected but that the U.S. was focused on assisting U.S.-based insurers. He said that in this country Ambac and MBIA were among insurers trying to raise capital.

Commissioner Voss said it was her understanding, based on the experiences of an Iowa-based AEGON subsidiary, that foreign insurers are not “on the top of the list” for U.S. assistance.

Rep. Keiser said there was an opportunity to finally end the solvency debate by comparing how various solvency approaches have fared during the economic crisis. He inquired as to the status of such regulatory analysis. Commissioner Voss responded that one European insurer had predicted to her that it would be in worse financial condition had it operated under Solvency II. She said in her opinion there would soon be a wide-ranging dialogue regarding what regulation had worked, what had not, and what should happen in the future.

Rep. Keiser said it was important to run models that would demonstrate the impact that Solvency II would have had on companies such as American Insurance Group (AIG). Commissioner Voss agreed and said she had just spoken with an academic regarding the need for NAIC to hire an outside third-party to calculate the “what-ifs.”

Ethan Sonnichsen added that the NAIC had released at its September meeting a comparison of the U.S. system versus Solvency II. He said the comparison addresses some of the challenges that small and mid-sized companies face when trying to gauge assets and liabilities. He said that the NAIC’s solvency modernization initiative would include a retrospective regarding what would have happened to AIG under different solvency requirements.

Rep. Keiser discussed the importance of ongoing dialogue between NCOIL and the NAIC in light of the real-time nature of the financial crisis.

IRS EFFORT TO IMPOSE EXCISE TAXES ON FOREIGN REINSURANCE RISK

Commissioner Voss said the IRS had issued guidance on a section of federal tax code relating to excise taxes on foreign insurers and reinsurers for transactions involving U.S. risk. She said there was concern that the IRS had misinterpreted the code.

Dennis Burke of the Reinsurance Association of America (RAA) said that currently premium money ceded offshore must be taxed. However, the new IRS guidance says that all further transactions on that risk, such as when a reinsurer buys retrocessional coverage, also must be taxed. He said that, according to the IRS, an American insurer that cedes risk is responsible for paying any additional taxes after that—even though, he said, the American insurer may be unaware of later transactions.

Mr. Burke said that U.S. insurer trade groups, in what he described as a “rare instance” of agreement, had submitted a memorandum to the Department of Treasury that objected to the IRS decision and outlined the legislative history of the federal tax. He predicted that Treasury action

in the final days of the Bush Administration was unlikely and that insurers would need to pursue legal options. He said that litigation to overturn the IRS ruling would be a challenge, given the current need for federal revenue.

Rep. Wald inquired about, among other things, a role for NCOIL. Mr. Burke said legislators should monitor the issue, since increased costs to insurers generally result in increased costs to consumers and other players in the insurance system.

Rep. Keiser asked for clarification of the issue, including the tax implications of ceding U.S. risk onshore versus offshore. Mr. Burke said that in a U.S.-to-U.S. transaction, no excise tax is paid because the U.S. reinsurer is required to pay income tax on the premium it earns from the insurer. Mr. Burke said that if the U.S. reinsurer retrocedes the risk offshore, however, the reinsurer must pay excise tax on that offshore transaction. The question, he said, is that if the IRS has already levied income taxes on the premium, then why should it be taxed again?

In response to a question from Sen. Leavell, Mr. Burke said that insurance purchased offshore is subject to a four percent excise tax, while reinsurance purchased offshore is subject to a one percent tax.

IAIS/NAIC INTERNATIONAL ACTIVITY

Mr. Barnert said that three key issues under International Association of Insurance Supervisors (IAIS) consideration include: the relationship between EU solvency discussions and international accounting standards; emerging International Accounting Standards Board (IASB) concerns regarding the financial crisis and accounting; and the status of an insurance contracts project.

Mr. Barnert commented on the “real-time” nature of the EU solvency discussions and said there was gridlock between the EU Parliament, the Council of Ministers, and the European Commission. He said the Council of Ministers had concerns regarding group-support provisions in Solvency II and wanted to pass Solvency II without them. He said the EU Commission, as well as European insurers, firmly opposed the idea.

Mr. Barnert said the issue was important because it would determine what kind of accounting insurers use—whether they follow solvency accounting, which he said relates more to financial protection, or whether they follow accounting that is more designed for investors.

Regarding IASB activity, Mr. Barnert said that both the IASB and the Financial Accounting Standards Board (FASB) were reacting to the global financial crisis by holding a series of roundtables to bring people from around the world together to talk about what they think the problem is and what the solutions might be.

Mr. Barnert said that what was emerging among international accounting standard-setters was a sense that they should have better discussions with insurance regulators to prevent accounting standards from having unintended negative consequences.

Rep. Wald asked about the difference between accounting for solvency as opposed to accounting for investors. Mr. Barnert said the primary difference was prudence—solvency-based accounting rewards conservatism, while investor-oriented accounting considers conservatism a negative.

Rep. Wald asked whether the two approaches would ever meet. Mr. Barnert said there already was some degree of unity in the U.S. In the early 1990s, Mr. Barnert explained, the NAIC

reviewed all GAAP standards to determine which ones were appropriate for U.S. insurers—resulting in U.S. GAAP—and then committed to reviewing all new issuances of GAAP in the same way.

In Europe, Mr. Barnert continued, insurers historically abided by one set of standards developed by their national regulators. He said that when international accounting standards came into play, European insurers did not want to follow two sets of accounting requirements. In recognition of the fact that no compromise has yet been reached, the latest insurance contracts standard allows European insurers to temporarily follow only their home-country accounting requirements.

Mr. Barnert continued that international accounting standards are being used in more than 100 countries worldwide, although most countries have not adopted the standards as originally set forth by the IASB. He noted that the U.S. Securities and Exchange Commission (SEC) requires any insurer wishing to use IASB standards to follow them as IASB adopted them. He predicted that uniform adoption may not exist for many years but commented that even modified IASB standards are a vast improvement over the earlier, more fragmented system. One of the things that became clear as the financial crisis began to unfold, Mr. Barnert said, was that even some form of international accounting rules is better than no international rules whatsoever.

Mr. Barnert said that, regarding insurance contract standards and fair value accounting, the IASB was discussing how to move away from the concept of “exit value,” which assumes that there is always a market for an insurance contract.

In response to a question from Rep. Wald, Mr. Barnert said that non-U.S. insurers submit their financial reports based in their local currency.

Mr. Barnert then discussed fair value accounting in more depth. He said that originally fair value meant that there was a willing buyer, a willing seller, and no duress under which a transaction might take place. However, unlike the stock market, Mr. Barnert said, there was no open market for these transactions and it was very difficult to determine the fair value of a private insurance placement that no one anticipating selling. He said that insurers had to hypothesize a suitable price, which he commented was imaginary “nonsense.”

Mr. Barnert said it would be more appropriate to look at the value of insurer liability as a going concern. In other words, he said, consider what the value of liabilities would be under the contract obligations—how much could the payouts be, under what conditions, and upon what events. Then, he said, figure out the actuarial possibilities of those things and calculate the amount that those odds come to—and you arrive at the contract’s value.

Mr. Barnert commented that although the “going concern” approach is commonsense, there were still many fierce advocates of the imaginary approach to fair value.

Mr. Barnert predicted that a role for legislators could emerge as Congress expands and accelerates its interest in financial services issues. He noted that GNAIE has no position on who should regulate the financial services industry but is concerned only that accounting standards are not confused in the debate.

Rep. Wald and Mr. Barnert briefly discussed financial services regulation in the context of the AIG crisis, which they agreed was due to AIG’s financial products division rather than to its insurance operations.

REINSURANCE COLLATERAL

Commissioner Voss recognized that the NCOIL Executive Committee has jurisdiction over NCOIL reinsurance collateral discussions, but she noted that the NAIC had developed a Reinsurance Regulatory Modernization Framework that sought to facilitate the entry of non-U.S. reinsurers into U.S. markets.

2009 COMMITTEE CHARGES

Rep. Wald said that proposed 2009 Committee charges were as follows:

- develop and enhance communications with foreign legislators and regulators, e.g., initiate and establish more formalized forum for communications between international insurance legislators as part of NCOIL meetings
- monitor and report on developments regarding IRS tax proposals for reinsurance risk
- monitor and report on developments in EU liability insurance
- explore areas of mutual recognition between U.S. and non-U.S. insurers
- monitor international accounting standards development in order to form an NCOIL position

Rep. Keiser suggested amending the final charge as follows in order to more clearly commit NCOIL to taking action:

- develop an NCOIL position on international accounting standards

Upon motions made and seconded, the Committee adopted both the amendment and the amended charges.

ADJOURNMENT

There being no further business, the meeting adjourned at 12:30 p.m.