

NATIONAL CONFERENCE OF INSURANCE LEGISLATORS
INTERNATIONAL INSURANCE ISSUES COMMITTEE
SANTA FE, NEW MEXICO
NOVEMBER 20, 2003
DRAFT MINUTES

The National Conference of Insurance Legislators' (NCOIL) International Insurance Issues Committee met at the Eldorado Hotel in Santa Fe, New Mexico, on Thursday, November 20, 2003, at 11:15 a.m.

Rep. Mark Young of Vermont, Chair of the Committee, presided.

Other members of the Committee present were:

Sen. Steve Geller, FL
Rep. Stephen Ehardt, MI
Rep. Mary Ann Middaugh, MI
Rep. Greg Davids, MN
Sen. Cal Larson, MN
Assem. Clare Farragher, NJ
Assem. Nancy Calhoun, NY
Assem. Ivan Lafayette, NY
Sen. William J. Larkin, Jr., NY
Sen. James Seward, NY
Rep. Francis Wald, ND
Rep. Dave Evans, OH
Sen. David Bates, RI
Rep. Brian Kennedy, RI
Rep. Craig Eiland, TX
Rep. Kathleen Keenan, VT

Also in attendance were:

Bob Mackin, Mackin & Company, NCOIL Executive Director
Susan Nolan, Mackin & Company, NCOIL Deputy Executive Director
Timothy Tucker, NCOIL Director of State-Federal Relations

MINUTES

Upon a motion duly made and seconded, the Committee voted unanimously to approve, as submitted, draft minutes of its last meeting, held on February 21, 2003, in Savannah, Georgia.

EU/U.S. DIALOGUE

Mr. David Matcham, Director of Operations for International Underwriting Association (IUA), gave a general overview of current European Union (EU) regulatory developments.

Mr. Matcham said that there are currently 15 member states in the EU passport system and that each recognizes the other 14. He said that the European Council of member States and the European parliament agree and issue directives to member states that they must implement. He said that there was no option and that fines and sanctions exist for those states that do not implement.

Mr. Matcham said that member states are free to add their own regulatory criteria. He said that FSA's regulation is in many ways significantly more than that required by the European Union. He said that for insurance and soon in reinsurance, a license in one member state is recognized throughout the Union. He said that this is, in effect, mutual recognition. Mr. Matcham said that companies are free to establish in the EU and can write large or mass risks from their home state, hence the term home-state regulation and not host regulation, which is the US system.

Mr. Matcham said that as a consumer, he could buy his auto or homeowner's cover from a Greek insurer. He said he chose not to do so because he preferred to maintain a local contact for any claims activity. However, he said, commercial clients often spread their coverage throughout the European Union, either over the phone, internet, by broker or direct mail.

Mr. Matcham said that there is no rate or form regulation throughout the EU. He said that there are varying guarantee systems throughout EU member states. Mr. Matcham said that only one country, France, imposes any form of collateral requirement on reinsurance recoveries.

Mr. Matcham said that the European Union had an especially busy agenda currently, in its attempts to streamline regulatory practices. He commented on six of these efforts, namely:

- completing the single market
- solvency in the insurance and reinsurance industry
- corporate governance
- insurance guarantee schemes
- reinsurance directive
- international accounting standards

Completing the Single Market

Mr. Matcham said that there is an initiative currently taking place known as the Lamfalussy process. He said that Lamfalussy is a Belgian who was asked to chair the so-called Group of Wise Men to devise a method to reform the regulatory framework for EU financial markets via a streamlined legislative process that is both speedy and flexible in order to boost market integration and EU competitiveness. Mr. Matcham said that the system contains four levels. He said that:

- Level 1 is where the European Commission will consult with industry and submit proposals to the European Council and Parliament who agree the political direction and scope of measures.

- Level 2 is where the high-level civil servants vote on proposals and are aided by a committee of regulators who make recommendations, review practices and conduct peer reviews.
- Level 3 sees regulators working to ensure a consistent and equivalent implementation of legislation.
- Level 4 is the enforcement process supported by cooperation from member states, regulators and the private sector.

Mr. Matcham said that this is the process by which, hopefully, the 2004 Reinsurance Directive will come into force. He said that the target is one of a fast track, with introduction in April and hopefully finalization by December.

Mr. Matcham said that the current process is too cumbersome and slow, so the necessary steps are now being taken to extend the process from the securities industry to the insurance sector. He said that certain amendments have to be made for this to take place and that heads of EU governments are now discussing this at the highest level.

Mr. Matcham said that, in addition, the Committee of Insurance and Occupational Pension Supervisors (CEIOPS) was formed in May 2003 as a Level 3 committee. He said it would advise the European Commission on technical measures to implement directives affecting insurance and pensions and would promote greater unanimity among regulators regarding application of EU rules. He said that it is, in effect, a move to harmonize EU regulation and move more to a single market. Mr. Matcham said that John Tiner, the Chief Executive of the Financial Services Authority (FSA), has agreed to be on the committee, which will be chaired by the Danish regulator, who is ex-Chairman of the International Association of Insurance Supervisors (IAIS) Reinsurance Committee.

Solvency in the Insurance and Reinsurance Industry

Mr. Matcham said that solvency is, of course, the key. He said that the objective is for all insurers to be subject to the same requirements and solvency margins, thereby ensuring EU policyholders are equally protected.

Mr. Matcham said that in February 2002, Solvency I was introduced as a system to improve the regulation governing the calculation of solvency margins. He said that it took account of local risks, i.e., EU states could adopt greater than minimum standards, as the FSA does. He said that it also raised the minimum amounts and index-linked capital requirements. He said, for example, that the minimum is now Euro 3m for retail business, which was previously as low as Euro 200,000. He said that solvency margins had been raised considerably and regulators had been given increased powers to intervene if consumer interests were threatened. Mr. Matcham said that for volatile business, such as MAT and general liabilities, solvency margins have been increased by 50 percent and capital must match the requirements of the risk profile.

Mr. Matcham said that no sooner had Solvency I been adopted than Solvency II was started. He said that Solvency II was a more wide-ranging system and looked at the overall financial position of insurers. He said it would assess whether more fundamental changes were required, but might not be fully completed until 2007 or 2008. He said it would consider the rules on assets and liabilities with risk-based capital enhancements, reinsurance arrangements and the implications of accounting and actuarial policies. Mr. Matcham said its ultimate aim is to have a closer match between solvency requirements and the real risk to which insurers are exposed and that it might use risk modeling to examine aggregations of risks, such as when many insureds could be affected by the same event.

Mr. Matcham said that Solvency II was closely linked to the reinsurance directive, regulation of reinsurers and the work of the International Accounting Standards Board (IASB). He said that at the moment it is, in effect, at Level 2 of the Lamfalussy process, with the scope already agreed. He said that CEIOPS will be heavily involved as part of the Level 3 discussions, which will include drafting of standards and guidelines to support the text of a new solvency directive.

Mr. Matcham said that, in summary, we can expect to see future EU solvency requirements being better geared to risks faced by insurers, which will encourage companies to adopt better internal risk management processes.

Corporate Governance

Mr. Matcham reported that the European Commission is considering a report prepared by a group of legal, business and government representatives on corporate governance. He said that the report contains a number of recommendations, including:

- disclosure by listed companies of corporate governance, structures and practices
- more coordination in EU member states
- examining the role and composition of audit committees
- examining the independence of non-executive directors

Mr. Matcham said that most of the recommendations are in line with current UK practice and have been drafted in the light of Enron and other financial disasters. He said that the UK follows the Combined Code, which is an important factor for Directors and Officers (D&O) insurers when assessing the risks of corporate governance. He said that the new proposals are effectively to create a more consistent, transparent, efficient EU system of corporate governance, but with the member states each ultimately controlling their own national combined codes.

Insurance Guarantee Schemes

Mr. Matcham said that discussions were taking place regarding the potential for having an EU framework for policyholder protection when a cross-border insurer fails. He said that this, in effect, centers on the situation in which a UK consumer bought auto insurance from a Greek insurer that failed. He said that there was a lack of harmonization in this area at present. Mr. Matcham said that many EU states have little provision to protect policyholders on a cross-border basis. He said that the UK is an exception with the Policyholders Protection Board, although others are being created throughout the member states.

Mr. Matcham reported that the European Commission concluded that there were unacceptable gaps to the operation of a smooth internal market. He said that as a result, a legislative text (basis for a directive) had been requested of the working group by the European Commission based on a home-state control regime and mutual recognition. He said that the initiative itself had not met with favor on the part of EU insurers, as they did not like the idea of a centrally imposed guarantee scheme and had raised questions of finance, moral hazard and distortion of competition as prime concerns.

Mr. Matcham said that he was sure this initiative had many months to run. He said that member states had their own views on the need and methodology but that the European Commission insisted that it was required for the integrity of the single market.

Reinsurance Directive

Mr. Matcham said that the Reinsurance Directive was an initiative to create a set of minimum regulatory criteria for reinsurers in the European Union. He said that at present reinsurance is regulated in different ways – from a full license (UK, Denmark) to indirect regulation through reinsured companies (Germany). He said that EU reinsurers are free to write EU business but that there are significant benefits in greater transparency in the solvency of reinsurers. He said that this is, in effect, part of the Solvency 2 process. Mr. Matcham said the EU has very strong reinsurers with long track records on international business; he said, however, that this Directive will strengthen the current position.

Mr. Matcham said that implementation would be through a passport system and home state licensing, i.e., mirroring the insurance directive. He said it would maintain the concept of a single market with one license also having the value of 14 other passports. He said that this would soon be extended to 25 passports, given the EU enlargement process. He added that upcoming European Parliament elections and enlargement, however, had unfortunately delayed the Reinsurance Directive. Mr. Matcham said that the Reinsurance Directive, which had already been drafted, would, therefore, be introduced in April 2004 for a fast track implementation by December 2004.

International Accounting Standards

Mr. Matcham stressed that while he was not a specialist in accounting, no summary of EU developments could omit the current proposals of the IASB, as they will have a material effect on EU insurers.

Mr. Matcham said that with growing calls for reform of accounting methods that would lead to changes in solvency measurement and greater transparency in insurance company financial statements, the IASB had reconfirmed its intention to produce an accounting standard for insurance contracts. He said that some people had identified this as a common language, as we currently have US, French, UK and German accounting standards and languages that are different. He said that this is not to say that these languages cannot be understood, that many of us can speak multiple languages, but comparison is not always easy.

Mr. Matcham said that the IASB has made insurance a leadership project and will lead the way in global thinking. He said that this is being carefully monitored by national interests.

Mr. Matcham said that Phase 1 states that all EU-listed companies must produce accounts based on the international accounting standards by 2005. He said that there were, however, gaps in the standards, especially on measuring insurance liabilities, that must be filled by IASB as part of Phase 2. He said that some listed insurers that use IAS use US-GAAP for this measurement, but it is not ideal. He said that those not on IAS use other measurement methods.

Mr. Matcham said that the final solution was for the insurers' acceptance of risk to be clearly recognized in their financial statements. He said that consistency and transparency would be improved if there was an accepted method of measurement and an ability to compare companies.

Mr. Matcham said that IASB's current proposals have caused insurers great concern and that while insurers support IASB's aims, they have raised concerns about:

- The risk of mismatch. Without getting too technical, from 2005 on, all assets would have to be measured on what is called fair value under IAS 39, which looks more to the current market value, while until IASB finishes its work on liabilities that cannot be measured other than under the national GAAP standards. This could lead to serious inconsistencies between measurement of assets and liabilities in financial statements. Artificial volatility in equity and premium income could mislead those who make use of insurers' financial statements, for example to buy insurance or reinsurance or make investments.

Insurers argue that it would conflict with IASB's objectives of transparency and comparability of financial statements.

- Timing. The final versions of IAS 32 and 39, which are the liability proposals, will not be available until March 2004 with Phase 2 of the insurance project not in force until 2008. This raises two consequences: first, IAS 32/39 will mean massive changes for insurance companies and there will not be enough time to meet the 1 January 2005 deadline; second, a further lack of transparency and clarity will result from financial statements. This will damage investors' confidence in the insurance industry.

Mr. Matcham reported that the CEA had proposed a postponement of IAS 32/39, thereby maintaining local GAAP in the interim. He said that it would require both the asset and liability solutions to be fully operable before IAS standards could be introduced.

Mr. Matcham said that both KPMG and PWC have sympathized with insurers in this case, noting the significant extra work in changing data-capture systems that would be required to comply and the potential confusion for stakeholders. He said the European Financial Reporting Advisory Group (EFRAG), an influential think tank, agrees as well, stating that mismatching and volatility would occur and would be confusing.

Mr. Matcham said that Phase 1 takes effect on January 1, 2005, whereby assets will be measured on fair value. But, he said, liabilities will be amortized under national GAAP standards until 2007 in Phase 2 because even the IASB recognizes the difficulty in creating the standard for liabilities; thus, the two-year delay.

Mr. Matcham concluded his presentation by saying that the list of EU current developments is not exhaustive. He said that there were other EU initiatives on transparency of information to potential investors, takeovers and environmental liability, among others. He said that the IUA/CEA would be pleased to advise and inform NCOIL legislators both collectively and individually on any of these issues.

CONSIDERATION OF PROPOSED 2004 COMMITTEE CHARGES

Rep. Young said the proposed 2004 Committee charges were to:

- Develop and enhance communications with foreign legislators and regulators
- Explore areas of mutual recognition in insurance regulation between U.S. and foreign insurers
- Monitor international accounting standards development in order to form an NCOIL position

ADJOURNMENT

There being no further business, the meeting was adjourned at 12:00 noon.