



International Association of Insurance Supervisors

Key Note Address of
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NAIC President Commissioner Kevin McCarty, NAIC Officers, NAIC CEO Terri Vaughan, Commissioners, ladies and gentlemen, thank you very much for the opportunity to speak to you at the Opening Session for the NAIC Summer National Meeting. It is a great honour for me to be here with you today. In the next few minutes, I would like to share with you my thoughts on the international agenda affecting insurance supervisors and insurance markets, and on the important contributions of the NAIC in this area.

You are all here to work together to address the regulatory challenges of the insurance sector in the United States. My aim is to highlight some of the major international initiatives in insurance and to suggest to you why they are important to you and, also, why your input and engagement are critical to the development of meaningful international supervisory practices.

As a starting point, it's important that we all recognize that, at the core of our mission as insurance supervisors is the protection of insurance consumers – or policyholder protection, as it's known in Europe. We pursue this objective in a variety of ways, using a variety of tools, but in the end, our duty is to create and preserve fair, open, secure, stable insurance markets for the benefit and protection of policyholders.



However – why is it so challenging to reach this goal? And why is it becoming more difficult nearly every day? There are several reasons for that – let me mention the most important ones.

Firstly, insurance providers are no longer just stand-alone legal entities but increasingly big and complex groups and conglomerates. This means that insurance supervisors cannot provide adequate protection to consumers and preserve stability in the marketplace if we do not effectively supervise insurance groups. The recent global financial crisis showed that supervision of the insurance sector at the legal entity level is important - but it is not enough. Group supervision is at the core of one of the biggest challenges we face today in insurance supervision, not only because insurance groups come in so many different shapes and sizes, but also because it requires us, as supervisors, to interact and cooperate more substantively and more frequently than ever before, and to look beyond the legal entity to gain insights into the operations of the entire group, including non-insurance activities.

A further complicating factor is the fact that many of these groups are not only insurance groups comprising exclusively insurance companies but may also include banks or securities firms. Consequently, the effective supervision of such groups requires us also to interact and cooperate with other financial regulators with whom we may or may not have an existing relationship. The financial sector has become increasingly interconnected, with banks, insurers and securities firms often competing for the same customers. At the same time, financial institutions across the board have engaged in ever more complex financial activities, all requiring more coordination and consistency in financial regulation.

We all know that today's financial marketplace is global, and this applies equally to the insurance sector. Not so long ago, in insurance it was primarily in the area of reinsurance that risks were covered across borders by global firms; today, an increasing volume of business is being written – including in the U.S. – by subsidiaries and branches of foreign – or, as you say here, “alien” – insurers. I understand that the Federal Insurance Office Advisory Council held a meeting last week that looked into this issue and, based on a McKinsey report, estimated that insurers today generate up to 33% of their new business from markets outside their home jurisdiction. So what we need is effective cross-border communication and cooperation among insurance supervisors. The IAIS is promoting such



interaction, and in particular the Multilateral Memorandum of Understanding (MMoU) on information exchange.

Finally, the insurance sector is more than ever before part of the financial system. Although insurance is based on a specific business model, it is highly interlinked with other financial sectors and the economy more globally. As a result, insurance supervisors must play an integral part in discussions about financial stability and restoring confidence in financial markets. This enhanced role also requires that all financial supervisors incorporate a macroprudential perspective and apply new tools to ensure comprehensive oversight of the stability of financial markets.

So, in summary, we have a large, often complex, interconnected, global insurance sector which demands a coordinated effort by all – supervisors and industry alike – to ensure that we are preserving a market that keeps its promises to consumers, and upholds an industry that is vital to the global economy.

I will now highlight for you two key international developments that we face today – better group supervision and a better focus on financial stability.

When we speak of group supervision, we are speaking about ensuring that supervisors are looking beyond the legal entity within their direct control to obtain a more thorough picture of the group to which the insurance entity belongs. This has not always been the case, and we have let consumers of insurance products down by assuming, as we have, that as long as the insurance entity was financially sound, it didn't matter what other risks were carried within the group, either at the holding company level or in other business units. I know that you at the NAIC have adopted a "windows and walls" approach to group supervision – this model indeed contains the critical element of looking outside the insurance entity into the rest of the group's business. But it also presents the challenge of making sure that you, as U.S. regulators, are talking to other supervisors of entities within the group; that you are able to and willing to share supervisory information with other supervisors; and that you are seeking a broader understanding of the full spectrum of risks within the group, recognizing the potential for contagion to the insurance entity and damage to the insurer's ability to meet its promise to its policyholders. We share the objective of enhancing the effectiveness of



insurance supervision but, if we do it right, we'll also be able to reap the benefits of greater efficiency.

I see the process as one of several steps, and I am encouraged that each of these elements is either in place in the U.S. or under consideration in the Solvency Modernization Initiative (SMI). The first element is recognition of the need to look beyond the legal entity and, with that, to secure the legal authority necessary to exchange information with others pursuant to binding agreements. At the IAIS, we recently approved our 30th signatory to a Multilateral Memorandum of Understanding (MMoU) on information exchange, and while only one of these so far is a U.S. state, there are others in the process and we urge you all to consider signing on.

A further step beyond securing the authority to exchange information is actively engaging in communication with other supervisors; and where multiple supervisors are involved, the Supervisory College is the structure that financial regulators have devised. Again, the NAIC's changes to the Insurance Holding Company Model Act and consistent implementation in the states of U.S. supervisors' participation in colleges is critical to achieving effective oversight of an entire group's operations and, ultimately, effective consumer protection.

At the IAIS, we are engaged in the development of a Common Framework for the Supervision of Internationally Active Groups, or ComFrame. Using the IAIS Core Principles and local group supervision as a foundation, ComFrame is designed to deliver a comprehensive, internationally consistent approach to the supervision of international groups. Once this framework is in place, it will itself serve as a foundation for reducing some of the ineffective duplication of effort among supervisors in the group, thus freeing supervisory resources which can be deployed for better use.

A final step in group supervision is to conduct comprehensive, globally consistent supervisory cooperation and oversight that incorporates "windows" or perspectives into all potential sources of risk within an insurance group. A key tool for meeting this objective is thorough but targeted financial reporting and disclosure and on-site verification. This allows supervisors not only to fully appreciate the risks within the group, but also to evaluate the risk management system in place across the enterprise. The greater the risk culture within



an insurance entity or financial group, the more comfort that supervisors can take that the insurers' promises can be met.

A better focus on group supervision will also contribute to better stability in the insurance sector. The challenge for insurance supervisors is to expand the scope of their responsibilities to look further into the broader concerns around financial stability; for many of us, this is uncharted territory. At the IAIS, we address these issues through a Financial Stability Committee which reports directly to our Executive Committee. This high level consideration is evidence of the priority that we give these issues at the IAIS.

As we take on the challenge of incorporating a market stability focus into domestic regulation and practice, we are dealing with the international aspects in coordination with the Financial Stability Board. The FSB, as it's known, reports directly to the G20 world leaders, and has a monumental task of developing policy – and monitoring – supervisory practices that will most effectively establish and maintain greater stability in financial markets and, by extension, the global economy.

A critical step toward creating more stable insurance markets is addressing “too big to fail.” At the IAIS, through tremendous effort and collaboration from our Members including the NAIC, we have developed influential reports that discuss why traditional insurance – and reinsurance – are not a likely source of instability, but that highlight the non-traditional and non-insurance corners of our sector for further exploration. Along these lines, we issued for consultation in June a draft methodology for determining whether any insurers should be deemed global systemically important insurers – or G-SIIs. We are in the process of addressing these extensive comments as we fine-tune a process which, similar to the banking exercise, will produce results that the FSB and national authorities, in consultation with the IAIS, will use to decide if there is a list of G-SIIs, most likely sometime early next year.

While much of our recent work at the IAIS has been developing a methodology for determining any G-SIIs, we have also worked hard on a draft paper to present the supervisory measures that should apply to any systemic insurers. We are examining ways in which we, in the insurance sector, can best address the challenges of ensuring proper



resolvability of systemic insurers, proper heightened loss absorbency, and more intensive supervision if there are, in fact, any globally systemic insurers. We will also issue this paper for public consultation, and rely on all of you to make your perspectives known to us.

These are just a few of the many issues that financial regulators and the FSB are addressing. Most important is remembering that it is in all our interests – supervisors, financial policymakers, the private sector and consumer groups– to work toward finding answers to the things that have gone so terribly wrong and to continue to work toward the ultimate goal – together – of sound, reliable protection for insurance consumers.

Before I close, I hope that I will see many of you later this afternoon. Immediately following the International Relations (G) Committee meeting, I will be joining NAIC Leadership in conducting our first IAIS Outreach Program. Together we will explore more deeply some of the issues I have just mentioned, and provide greater context for the work of the IAIS.

Thank you very much for your time and attention.