



On August 9, 2011, SCOR SE, a global reinsurer with offices in more than 31 countries, acquired substantially all of the life reinsurance business, operations and staff of Transamerica Reinsurance, the life reinsurance division of the AEGON companies. The business of Transamerica Reinsurance will now be conducted through the SCOR Global Life companies, and Transamerica Reinsurance is no longer affiliated with the AEGON companies.

While articles, treaties and some historic materials may continue to bear the name Transamerica, AEGON is no longer producing new reinsurance business

# The Forecaster

## Solvency II – Equivalence Brings It Home



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*Purely domestic US life insurers may view Solvency II as exclusively a foreign concern. However, efforts are under way for the US to achieve Equivalence with this European solvency standard. This could have implications for regulation, governance, capital and reserve calculation and, ultimately, product design for all companies operating in the US.*

*Joe Gilmour, Executive Vice President and Chief Financial Officer, discussed Equivalence with Howard Mills, Chief Advisor for Deloitte's Insurance Industry Group. Howard believes that Equivalence is an issue equally important to the US and the EU, and that such status will be attained here. However, when Equivalence will ultimately be granted is difficult to determine given the current regulatory environment in the US.*

*At Deloitte, Howard consults with the firm's insurance and reinsurance clients worldwide in areas ranging from growth and globalization to managing complexities of regulatory compliance. Before joining Deloitte, Howard served as an Assemblyman and later Superintendent of Insurance for the State of New York. As Superintendent, he took leading roles within the International Association of Insurance Supervisors (IAIS) and in the NAIC's pursuit of principles-based regulation. He is a graduate of Marist College and holds a master's degree in Government and Public Affairs from The American University.*

### *Joe Gilmour: What does Solvency II Equivalence mean?*

**Howard Mills:** The concept relates to rules within Solvency II that lay out regulatory characteristics that non-EU member countries must have in place for their capital standards to be deemed "equivalent" to Solvency II standards. While a key component of Equivalence is acceptable reserve and capital requirements, it also includes such factors as governance and regulatory transparency.

Solvency II represents some fairly significant changes in how an insurance company views overall risk management, with strong links between decision-making and quantitative measurement of risk and precise measurement of capital and the deployment of capital. It's hard to argue with the concepts, and I think EU and non-EU countries are in agreement here. Where we face obstacles is in getting to convergence. In the case of some non-EU countries, like the US, they feel that they are there already.

### *JG: How equivalent is the US solvency regime to Solvency II?*

**HM:** It depends on who you talk to. Many in the US – the NAIC and other regulators – feel that their system works, but the EU is less confident that the US regime is up to their standards. The NAIC is getting pressure to get on board from the International Association of Insurance Supervisors (IAIS) and, at the same time, it's getting pushback from some of the US trade associations who are urging them not to feel pressured and move too quickly. The NAIC now has come up with its own Solvency Modernization Initiative (SMI), which the EU obviously is not too pleased with.

Right now, the EU and the NAIC fundamentally differ in that the EU is looking for true global convergence while the US is saying, hold on – is this really realistic? Perhaps a more obtainable approach would be one of mutual recognition. In other words, we don't

think we'll ever get to the point where every regulatory authority will have the same line-by-line requirements. But if we understand each others' processes and have confidence in what the other regulators are saying around capital adequacy and solvency of the companies they regulate, then we can reach a state of mutual recognition and trust.

But there is definitely a lot of friction. SMI is viewed by many in the EU as maybe a stall or certainly not the total plunge-in that they would like to see.

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### Report Card for US Regulation

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*JG: In the eyes of the EU what are the perceived weaknesses in US regulations?*

HM: What I'm about to say is what I said when I was a regulator: I think there are valid concerns about the state-based insurance regulation in the US. The NAIC's ability to move collectively and move quickly has been an historic problem.

At the height of the financial crisis there was some hope, certainly among many in the global community, that the US would move to a single regulatory system. I think the global community, both regulators and companies, would have welcomed that. Obviously that didn't happen. The state-based system is alive and well.

Dodd-Frank created the Federal Insurance Office (FIO), but even that has been watered down significantly. And now it's further complicated by US domestic politics. Many of these new regulatory agencies created by Dodd-Frank – including the FIO – will be starved of funds. It is an entity but there's no money to hire anybody. What does that mean?

A couple of years ago, spurred on by the economic crisis, many were looking at the possibility of greater clarity in the US regulatory structure. What we're getting is actually even cloudier than it was before. There's a tremendous degree of uncertainty hovering over the US regulatory system right now, and the prospects for it becoming clear in the near future are not good.

*JG: I know Deloitte is also involved on the banking side of the financial industry.*

*Regulation seems to have gone the other way there. Everyone is on board with Basel III. Do you see a difference in where banking and insurance regulation ends up?*

HM: I do, because there is a fundamental difference. One of the problems that we've had from a regulatory perspective with banks and insurance – and you see this in the passage of the Dodd-Frank legislation – is that the insurance industry feels that it's been lumped with the banking industry. Dodd-Frank looks at insurance through a banking prism – a prism of systemic risk. The insurance industry is unified in saying that it shouldn't be considered systemic.

I agree that the banking industry is comfortable with a single regulatory system. But the insurance industry probably could stay with multiple jurisdictions and multiple regulators for a long time.

What's interesting is that a lot of life insurers who historically favored the old optional federal charter also own thrifts. Now, by virtue of owning a thrift, they face the prospect of coming under federal authority as well as their existing state domicile regulator. And now they're going, "My God! And we were wishing for this?"

*JG: Aside from its state-based nature, are there other perceived weaknesses?*

HM: Yes. For one, the regulatory process is very, very politicized. And I say this as a former insurance regulator and before that a state legislator. You can see this in the rate approval process. The ability to grant adequate rates on things like health insurance, automobile or even homeowner's coverage in coastal areas is very influenced by politics, and certainly does not come down to a fair actuarial analysis of what's justified to keep a market strong.

Also, and partly as a consequence of the economic crisis, there is a huge focus on consumer protection, transparency and disclosure. It's hard to argue against this, but we're seeing regulations that require so much information be passed on to the consumer that you must ask whether it's of any real value to them. When policyowners receive a 30-page disclosure statement, does

it educate them or further confuse them?

Finally, the state budget crisis is a relevant weakness that gets right to the heart of your question in terms of regulating effectively. Across the country we see state regulators retiring or leaving the agencies and they are not being replaced because of budget restraints. Departments will be increasingly resource constrained, and they are losing a lot of institutional knowledge. This will affect everything from the mechanics of paperwork, rate and form filings and approvals to ultimately the quality of the regulation. Companies should be aware that they can expect the process of dealing with regulators to become more difficult just because the insurance departments will be so resource constrained.

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## Regulatory Competition

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*JG: What kind of company benefits most from Equivalence? In other words, who may get an advantage from Equivalence if the US stays in one regime and the EU is in another?*

HM: I'd say that European-based multinational life insurers are probably best positioned to benefit because their subsidiaries could avoid dual-reporting bases if they get Equivalence. I think non-EU-based multinational life insurers may receive some benefit because all the companies would be on an Equivalence basis. They can continue doing what they were doing before.

At the other end of the spectrum, a purely domestic life insurer is probably least positioned to benefit because without Equivalence they may have some competitive advantage. Additionally, attaining Equivalence will bring changes to their local regime which certainly could be harder for them. For a purely domestic European life insurer I'd say it's neutral.

*JG: State-based regulation in the US has led regulators to compete for insurer domiciles. What's the likelihood that EU-based companies may re-domesticate to a perceptively more business-friendly regime that achieves Equivalence?*

HM: Absent the regulatory uncertainty that we've already discussed, I think you probably would see companies looking to re-domesticate to more favorable regimes. The problem is, how do you figure out what is the best regime? What might be seen as more favorable today could dramatically change a year from now. So I think that moving around may be frozen somewhat until we see greater clarity and certainty.

*JG: What countries do you think will obtain Solvency II Equivalence and replicate it locally?*

HM: The EU has mentioned Bermuda, Switzerland and Japan as the first wave of jurisdictions to gain Equivalence. Switzerland is seen as attractive because many companies believe that Switzerland will almost definitely get Equivalence and certainly won't be more onerous than being in the EU – and possibly even a little less onerous. If you're already looking for access to the European market and you're not there already, and you're in a market where there is a risk that you won't get Equivalence, where would you go? Would you go into Europe itself or would you park yourself on just that side and expect to get Equivalence?

*JG: Do you think it's possible that Bermuda could get P&C but not life Equivalence?*

HM: No, I don't think Bermuda regulators are really contemplating that. I think they're looking at the industry holistically and from a long-term perspective. They very much want to remain a hospitable place for insurance companies, but it's important that they demonstrate their oversight strength. It's very important to their economy that they be at the forefront and be seen as a truly progressive and modern regulator.

Insurance companies look at regulators and, of course, they don't want to move towards a tougher, harsher regulatory environment. But on the other hand, insurers see the entire world moving toward a tougher standard, particularly around capital, and they're looking at rating agency

pressures. They want to be domiciled in a place where rating agencies and other financial observers have confidence, so that when the regulators says your company is sound, the rest of the world will agree with them.

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## Rating Agency Involvement

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*JG: What role do the rating agencies play in the Solvency II debate? Do you think they will take the side of Solvency II over US RBC?*

**HM:** The rating agencies may not be involved directly in Solvency II discussions, but the reality is they'll play a big role. I think that they will start looking more closely, especially given the conflict between SMI and Solvency II. Right now the rating agencies are very US-centric, but I think, depending on how the SMI plays out, they may start to shift their weight towards Solvency II, which could help move the parties together. The longer this process plays out the more we may see rating agencies come to the fore and be more engaged.

*JG: The rating agencies already like strong risk management regimes, so isn't it hard for them to argue with the principles of Solvency II?*

**HM:** Exactly – the better the risk management, the better deployment of capital. If a company does get to a point where they have this greater accounting and greater tracking of capital, then they may have greater flexibility in how to deploy that capital and they can hold less of it in reserve. Obviously, rating agencies will look favorably on this.

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## The Timeline

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*JG: Solvency II was envisioned to be in place by 2012. Given everything we've discussed, is this achievable?*

**HM:** I wouldn't be surprised if we see an extension of at least another year. At the end of the day, as much as the EU would like to think they can force this, they really need to be pretty close to the US. Likewise, the US regulatory world is mindful of the competitive disadvantage US companies could face if we're not aligned with the EU. So there are incentives for the parties to try to reach agreement.

So it shouldn't be too surprising if EU regulators added another quantitative impact study (QIS), which is a convenient way to extend the timeline without appearing to be soft. Instead of delaying, you're adding more requirements, more tests, more due diligence.



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