



**INTERNATIONAL ASSOCIATION
OF INSURANCE SUPERVISORS
1994 ANNUAL REPORT**

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I. Summary of Activities

A. The Executive Committee

The Executive Committee met for the most part on a monthly basis via conference call to discuss business matters and committee activity. Among the tasks completed were:

- Incorporation of the IAIS in the United States as a non-profit association
- Established a checking and investment account for the IAIS with United Missouri Bank located in Kansas City, Missouri
- Accepted and processed applications for IAIS charter membership
- Coordinated the IAIS first annual conference held in Baltimore, Maryland
- Finalized services contract with the National Association of Insurance Commissioners (NAIC) to provide administrative and financial support to the IAIS
- Established and approved seven committees: Budget, Basic Market Data, Education, Directory, Emerging Markets, Supervision of Financial Conglomerates, Exchange of Information, and the 1995 Conference Planning Committee

B. The Committees

Budget Committee

- Worked closely with the NAIC accounting department to oversee accounts receivable and payable of the IAIS.
- Prepared prospective 1995 IAIS Budget.
- Oversaw IAIS audit by Deloitte & Touche.

Basic Market Data

- Developed draft chart to be distributed to and completed by IAIS members on the basic market data of each member country.
- Discussed plans to provide members and interested parties the processed information.

Exchange of Information Committee

- Developed language for the *Recommendation Concerning Mutual Assistance, Cooperation and Sharing of Information*.
- Attended joint meeting with the National Association of Insurance Commissioners Alien and Confidentiality Licensing Working Group.
- Drafted forms for the exchange of information among members.
- Coordinated efforts to collate existing laws on the exchange of information.
- Prepared a second exchange of information questionnaire.
- Explored the possibilities of establishing an international database.

Directory Committee

- Distributed survey to obtain names and addresses for IAIS Directory.
- Developed and distributed a draft world directory of insurance supervisors and interested parties.

Emerging Markets

- Prepared a paper on emerging markets.

Supervision of Financial Conglomerates

- Will organize discussion with respect to the BASLE Committee report.

Education Committee

- Coordinated efforts to produce an IAIS training manual.
- Held a meeting in Guernsey to discuss training manual.
- Discussed coordinating seminars at which the training manual will be used.
- Remainder of workplan to be approved by the IAIS.

1995 Conference Planning Committee

- Oversight of preparations for the 1995 Conference in St. Louis, Missouri, USA.
- Distributed program to over 3,000 interested parties.
- Organized press packets to be distributed to the members.
- Coordinated panel presentations.

C. Miscellaneous

- Prepared a report entitled "Future Role of the IAIS".

D. The IAIS Secretariat

The following list highlights some of the major tasks performed in 1994 by the IAIS Secretariat at the request of the IAIS Executive Committee:

- Published the December and March issues of the IAIS Newsletter
- Produced certificates for charter membership, former executive committee members, and the original structure working group
- Handled IAIS correspondence
- Coordinated registration for the 1994 IAIS Conference
- Coordinated panel presentations for the 1994 IAIS Conference
- Summarized the panel presentations from the 1994 IAIS Conference
- Started planning for the IAIS 1995 Conference
- Coordinated registrations for the 1995 Conference
- Prepared memo on observer status
- Researched the tax implications of observer status in the IAIS
- Prepared agendas and coordinated monthly conference calls
- Produced and distribute the 1994 Annual Report
- Oversaw the audit by Deloitte & Touche

Summary of the
Panels Presented
at the
International Association
of Insurance Supervisors
First Annual Conference
June 13-16, 1994
Baltimore, Maryland

Where indicated full text of the presentation is available from the Secretariat of the International Association of Insurance Supervisors, c/o NAIC, 120 West 12th Street, Suite 1100, Kansas City, Missouri, USA 64105-1925.

IAIS Opening Session

David Walsh, Chair of the International Association of Insurance Supervisors (IAIS) and Director of Insurance from the State of Alaska introduced the members of the Executive Committee: George Pooley, Australia; Jean-Marc Delporte, Belgium; Nigel Bailey, British Virgin Islands; Laszlo Asztalos, Hungary; Alfredo Solloa Junco and Fernando Solis Soberon, Mexico; Adelita Vergel de Dios, Philippines; Piet Badenhorst, Vice-Chair, South Africa; Mohsen Thabet, Tunisia. He explained the difficulty in starting an organization of this size, especially an international organization. He reported that 1) the IAIS is a non profit organization incorporated in Illinois, 2) the IAIS has signed a secretariat agreement with the NAIC, 3) a bank account has been established, and 4) the deadline to become a member has been extended until June 16, 1994. He informed the group that additional members are needed. He encouraged all of the current members to recruit new members in order for the IAIS to provide more services. He reported that the Executive Committee has been developing a work program including creating a directory of the international insurance supervisors which will be sent out to all of the members soon after the meeting. In conclusion, he thanked those people responsible for getting the organization started and those individuals who have helped to keep it going.

Dick Self, Deputy Assistant

U.S. Trade Representative for Services and Investment

Soon there will be greater cohesion and cooperation among the countries. With the Uruguay round one can see a milestone in the area of trade. NAFTA has shown the willingness of countries to open up their markets to one another and this is particularly obvious in the area of developing countries. These countries have changed their outlook and this has had a tremendous impact on the global economy. In light of all this, one of the areas that will be greatly affected is the insurance industry.

Greater openness has occurred in the area of services. Thus, the news is largely good. There are, however, still some not so good things. Some markets still remain closed. For example, China, a large market, is seeking membership in the World Trade Organization, but is still a highly regulated market. Japan, too, has a long way to go in opening up its insurance market and examining its private companies.

The participating countries did not complete negotiations at the Uruguay Round. Several countries received an extension in order to improve their schedule of commitments. The most important aspect of openness is that any regulations established should not undermine the ability of foreign companies to do business in their home market. There are other important issues such as new products, rate flexibility, and reinsurance that need attention by the IAIS. Reinsurance is a reminder of the limitations and danger of this market. The IAIS is a great forum for discussing the issues that surround reinsurance. The United States would like to see an open market and sees this as good for the world economy, aiding developing countries, and a source for capital formation.

Reinsurance

George Pooley, Australia, Chair
Commissioner of Insurance
Insurance and Superannuation Commission

Richard Smith, Australia
Deputy Commissioner General Insurance
Insurance and Superannuation Commission

The Australian Superannuation Commission is responsible for the supervision of all life and general insurers in Australia. Australia federally regulates insurance. There is a standard solvency test for all insurers and an insurance company can reduce its solvency margin requirements by reinsuring. The Commission looks to the philosophy, structure, and the detailed program in assessing a company. There is a set of reinsurance guidelines with which insurance companies can do their own self assessment. These guidelines include highest risk retention, maximum event retention, spread of reinsurers and overall level of reinsurance. These are the key for approval of reinsurance in Australia. Reinsurers may reinsure up to 60% of a company. There are no restrictions on how much an insurer can reinsure with an authorized Australian reinsurer. The Commission applies these guidelines on a flexible basis and many companies seek approval outside the normal guidelines. The Commission reviews companies seeking special approval on a case by case basis.

Australia is susceptible to several large catastrophic risks. Generally, reinsurance has been cheap and available. More recently, reinsurers have suffered losses causing capacity to decrease and deductibles to increase. Changing markets, privatization, and new players entering the market characterize recent trends in Australia. In short, after being through a difficult time, the industry started to get back on track in 1992. The market is well capitalized, meets solvency requirements and provides adequate reinsurance cover. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Jean-Louis Bellando, France
Commissaire Controleur General
Commission de Controle des Assurances

In France there is no filing requirement for reinsurance companies. Permission to operate is completely free. This does not mean that there are no problems. There is a need to protect the policyholder and the French accomplish this through regulation of the direct insurer. With the changes that are taking place on an international scheme the French government has discussed additional regulations to cope with the situations that may arise.

The purpose of regulation is to protect the insured. This depends of course on the solvency of the direct insurer. Thus the French regulations aim at making sure that the direct insurer can always pay its claims even in the event of bankruptcy of the reinsurer. When applying for a license, the direct insurer must submit a business plan that includes a section on what the reinsurance plan will be. Later, supervisors check that reinsurance treaties meet the company's needs and capacities.

Regulators base financial control on significant reserves, assets to cover the reserves, and the level of solvency that goes beyond the minimum. The reinsurance problem lies with assets covering the reserves. French insurance law determines assets, in order to protect the policyholder. Reinsurance debts are accepted for representation of technical provisions only if they are accompanied with securities. The unreliability of certain letters of guarantee prompt the French regulators not to accept them in the case a reinsurer going bankrupt -- so the French system appears to work. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Dominique Giorgi, France

Administrateur Civil

Ministère de l' Economie

In France, supervisors do not regulate reinsurers to the same degree as direct insurers. Because concerns grow with an increasing international reinsurance market, the French desire to put a system in place that will protect reinsurers. These regulations will not affect foreign reinsurers. Such a system is currently being reviewed (it has since been made into law and will be in force on January 1, 1995). The philosophy behind reinsurance regulation in France will have four aspects: 1) the reinsurer will be subject to the same accounting rules as direct insurers, 2) reinsurer will provide information in its annual report for control 3) managers of reinsurance incorporated in France will be subject to fit and proper rules, and 4) the insurance commission vis a vis the insurance companies will keep on controlling on a gross-of-reinsurance basis and the ability to sanction in this area. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Dr. Knut Hohlfeld, Germany

President

Bundesaufsichtsamt für das Versicherungswesen

Germany is home to several professional reinsurers. Germany is the domiciliary for some of the largest reinsurers. Therefore, German supervisors are particularly interested in reinsurance. Foreign reinsurers are not subject to any supervision in Germany. They have free market access. The home country, therefore, regulates the insurer. If there are doubts about foreign reinsurers, German supervisors will not allow primary insurers to cede business to them. Germany requires reinsurers to furnish a detail account of their business plan. The combination of direct and indirect supervision has resulted in no German reinsurer going under. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Nigel Bailey, British Virgin Islands

Insurance Supervisor

Financial Services Inspectorate

The British Virgin Islands (BVI) regulates reinsurance to the same degree as direct insurance. For example, they have the same solvency requirements. It is easier because of the specialized nature of offshore reinsurers. On the other hand, because the risk is narrower the reserving problems are more drastic. In the BVI they look at the people running the company and determine the "fit and proper status" of the people and make sure they know something about what they are reinsuring. Some of the problems that have arisen regard reinsurance pools. The situation arises when "you meet yourself around the corner." They try to test each reinsurer which in practice does not always work. The BVI supervisors will not normally allow more than three levels of reinsurance unless they can easily follow the trail.

In general, the reinsurance market in the Caribbean has had difficulty. There has been a reduction in capacity due to hurricane and earthquake losses. The period is over where one cannot obtain reinsurance, but it is no longer proportional to the demand. The premiums have risen, however, the rates themselves are about the same as twenty years ago. The trouble is that property values are much higher. As a result the policyholder must bear the burden of the additional costs. Possible solutions include reinsurance pools; but lack of capital remains a problem. It is possible that in the future Caribbean banks will become the reinsurers.

Steven Foster, United States

Virginia Commissioner of Insurance

In the United States the supervisory bodies focus on the ceding company as opposed to the reinsurer. Regulators require the reinsurer to issue a credit statement to the ceding company. U.S. regulators do not obligate foreign insurers to become licensed or otherwise accredited in a U.S. jurisdiction to transact reinsurance business. An accredited reinsurer is one who meets a state's requirements for becoming a reinsurer. They must, however, put forth collateral. Proper collateral includes cash, securities, or irrevocable letter of credit. Without this collateral the ceding company cannot claim a deduction of liability. Nearly every state requires that domestic insurance companies meet specific standards before they can claim a deduction of liability on their financial statement.

As to changing markets, insurers are free to do business with any reinsurer regardless of the domicile of that reinsurer. The causes for regulatory concern are for the most part market place capacity and the collectibility of balances recoverable from reinsurers. At present there appears to be ample capacity for most lines with notable exceptions. The high solvency requirements have affected under-capitalized reinsurers. Historically, the U.S. has allowed the marketplace to determine rates and premiums for reinsurers. Regulators believe that the current regulatory system is sufficient to deal with foreign reinsurers, i.e., the collateral mechanisms. The NAIC, however, has recently introduced a model law, "The Fronting Model Act," that deals with unauthorized insurers and reinsurers.

In sum, any effort to address the issue of insurer solvency needs to recognize the significance of recoverability of reinsurance. U.S. regulators have access to extensive data and if used effectively they can focus on those companies facing financial problems. Obviously there is no guarantee that the U.S. regulatory tools will catch every failing reinsurer. Some U.S. lawmakers, both federal and state, like the idea of more regulation of reinsurance. The NAIC has proposed legislation that would have the NAIC be the "gatekeeper" for reinsurance, but at this time there is no legislator willing to introduce such legislation. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Jonathan Spencer, United Kingdom
Head/Insurance Division
Department of Trade and Industry

The United Kingdom is home to a large reinsurance market. There are nearly 200 companies doing reinsurance business in the UK, plus the Lloyd's market. Therefore there is a large interest in reinsurance. The one common interest is watching the quality and extent of the outwards reinsurance protection of a direct insurance company. In the UK credit is allowed for reinsurance for the purposes of solvency assessment up to a maximum limit of 50% of the premium income ceded. The UK does not limit the choice of reinsurers and does not impose conditions on the financial arrangement from the cedent. If there is concern about the reinsurer then the UK regulators approach the UK insurer. A sound reinsurance market is essential to a sound insurance market. The supervision of reinsurers in the UK is almost identical to the supervision of domestic insurers. This includes solvency requirements. Some minor changes will occur with the implementation of the third directives.

The capacity of reinsurance has decreased with an increase in catastrophes. Therefore premiums and rates have increased. This, however, has also led to the emergence of new capital with Bermuda functioning as a primary source of new capital. Most likely, the number of catastrophes will continue to increase and this will lead to an increase in rates and premiums.

It is not desirable for all countries to have the same regulatory regime but there is a need for everyone to be heading in the same general direction. The UK adopts broad brush principles instead of specific rules. The difference between the U.S. and the UK are not all that apparent. Therefore the approaches are not incompatible and other countries could use these approaches as possible models. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Disclosure of Information the Insurance Industry

**Piet Badenhorst, South Africa, Chair
Executive Officer**

Financial Services Board

The dual function of disclosure is to 1) promote accurate investment analysis -- not only by regulators but also institutional investors, investment advisers, etc., and 2) to protect unsophisticated investors from unfair treatment. Disclosure indirectly encourages those in the financial services industry and the corporate world to adhere to higher standards of conduct. In South Africa, in order to provide a meaningful disclosure regime, regulators reached an agreement for the establishment of interest groups for the various segments of the financial services industry. The aim of the interest group is to compile specific audit manuals, and specific audit procedures and standards for the auditing of the risk areas of a particular financial institution, and to focus on the manner and the extent to which such an institution discloses information in its financial statements.

The disclosure of product information to consumers is a more difficult problem with no easy answers. Disclosure alone is not enough to prevent investors from making risky or even worthless investments and the imposition of specific rules often supplements disclosure. A three tier system of disclosure including information regarding the product, information regarding the intermediary, and information regarding cost plus the suitability rule is currently under consideration for the Republic of South Africa.

One should remember that the compulsory disclosure of information is a form of regulation which is an alternative to what otherwise might be a perceived necessity for more direct regulation of the financial services industry. Disclosure also ties in with the approach of less regulation by supervisory authorities but improved supervision by investors themselves. The media could also help in the area of informing consumers. One should keep in mind, however, that with a disclosure regime come additional costs that one should weigh against the expected benefits. Further, a disclosure regime should apply fairly and equally across the board to all financial institutions. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

**Dr. Knut Hohlfeld, Germany
President**

Bundesaufsichtsamt für das Versicherungswesen

Up until July 1, 1994, Germany required insurers to have their general policy conditions approved by the German insurance supervisory authority. In some circumstances, the supervisors would approve premiums beforehand. Thus, there were no regulations regarding the disclosure of information. Beginning July 1, 1994, EU legislation will abolish the requirement of prior approval. This change will result in establishing new ways to protect insurance customers. The present law requires insurers to provide the insured with information prior to issuing a policy and throughout the term of the contract. Insurers must supply additional information in the case of life insurance. The requirements imposed on the insurer were controversial in Germany. The insurance industry believes that the requirements were too extensive and of little practical use. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

George Pooley, Australia
Commissioner of Insurance

Insurance and Superannuation Commission

In Australia, the Insurance and Superannuation Commissioner administers the disclosure regime for insurance. The *Insurance Contracts Act of 1984* covers general and life insurance contracts. It requires that the basis of the agreement between insured and insurer is a contract based on the utmost good faith of each party. The *Insurance (Agents and Brokers Act) of 1984* aims to strengthen the financial stability of the insurance industry overall by regulating the activities of life and general insurance brokers and agents. Regulations have strengthened the disclosure regime in Australia in recent years. This was in response to a demand from customers for more effective and informed choice of product. Last July Australia developed a series of changes to promote greater disclosure of information to policyholders and potential customers of life companies. Australia expects to finalize these changes this year. Overall these changes attempt to inform the consumer and improve the information that the consumer receives. Circulars 304 and 305 cover disclosure requirements for investment and risk cover policies. These circulars came into force progressively from January 1, 1994 and strengthen the product disclosure rules.

The most controversial issue in Australia over disclosure relates to commission disclosure. Life insurance companies and agent professional bodies have accepted such disclosure, however, individual life agents continue to oppose commission and charge disclosure. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Report on the GATT Agreement, European Union, NAFTA, OECD

David Walsh, USA, Chair
Alaska Director of Insurance

John Thompson, Canada, NAFTA
Deputy Superintendent

Office of the Superintendent of Financial Institutions

Canada's regulatory system is different than United States and Mexico, but NAFTA will not change this. Each of the 10 provinces have regulatory legislation on how companies operate. At the federal level, legislation is also in place to regulate and supervise companies. Primary regulation is of solvency. The federal government regulates most insurance companies. Banks can own insurance companies and vice versa. In property and casualty no single company has a monopoly. Ten companies dominate the life insurance market.

NAFTA has opened the market between the U.S. and Canada but it is only a marginal difference. NAFTA has likewise opened the market between Canada and Mexico, although there are no companies in either one from the other. NAFTA has not increased the flow of cross border trade between the U.S. and Canada. The fact is that Canada has been operating extensively, for quite some time, internationally. The Canadian insurers have not taken the challenge to move into Mexico at this time.

NAFTA provides a facilitative environment for Mexico and the United States and Canada to move each other's market. The host country as well as the home country will regulate the foreign insurer and this will lead to overlap in regulation. Regulatory differences exist in accounting, reporting, and capital standards; all of which have a potential to cause conflict. These affect decisions made by countries when deciding whether they should enter a country. The Canadian market is small, sophisticated, diverse, spread over a large region and saturated. It is thus a difficult market to enter. NAFTA therefore has not done much to change the situation. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Fernando Solis Soberon, Mexico, NAFTA
VicePresidente de Desarrollo

Comision Nacional de Seguros y Fianzas

Before NAFTA the U.S. had a market share of 35%, Canada had a market share of 2.4%, and Mexico had a market share of 0.25% of the global premium market. Mexico, however, represents a market with enormous growth potential. Before NAFTA a consumer would have had to physically cross the border to have cross border trade in insurance. Mexico has been very open since 1990 to investors in the capital and equity of their insurance companies. Thus since 1990, a foreign investor can hold 49% of the capital and equity of a Mexican insurance company, up from 15%.

Chapter 14 of NAFTA states the applicable requirements. The agreement grants the Parties the authority to set up a financial institution in the other countries. No Party can adopt a measure that

would restrict future cross border trade. Generally, one Party cannot prevent another Party from advertising in their country for their financial services and they can't treat a foreign company any differently than a domestic provider of financial services.

The NAFTA agreement has an impact on both the micro and macro economic level. Increased competition will force insurers to become more efficient and find better ways to market and cut costs. The six year transition, however, will allow the companies to strengthen their market. The agreement itself will increase the demand for insurance in Mexico. Greater industrial activity will definitely result in an increase in the demand for insurance. NAFTA's most dynamic effect will be in the insurance sector.

Patrick Pearson, European Union Insurance Division European Commission

The Commission has the authority to promulgate directives and enforce those regulations among the member states. The EU has been active in insurance since the 1960s. The first efforts in direct insurance were in the 1970s. The EU implemented the second directives in the late 1980s. The second directives laid out the freedom for cross border services among the members, but only covered large risks and situations where the consumer took the initiative. The third directives will go into force on July 1, 1994. The third directives allow an insurance company access to the insurance market in all member states. The EU is the most open market in the world. Under the treaty, the EU will consider any third country wishing to operate in the EU as an EU insurance company. The directives will apply fully to that third country.

The most important aspect of these directives is implementation. Those who have not implemented the directives in time will be at a competitive disadvantage. The barriers that will still exist on July 1 will be correct implementation, timely implementation, and the barrier of taxation. The focus of the Commission after July 1 will be on the winding up and liquidation procedures on the table at this point in time, insurance companies that are part of a much larger group, and the solvency of insurance undertakings.

Bruce McAdam, USA, GATT U.S. Department of Commerce International Trade Administration

Foreign based insurers account for 10% of the U.S. premium market. United States insurers have also realized that going international is essential to their competitiveness. The basic U.S. services trade policy is that the U.S. seeks the liberalization of services markets world wide in which U.S. service markets must compete. The United States seeks an open competitive services market in which sound firms compete fairly in the price and quality of products. Greater liberalization in the services market is essential to economic growth.

The Uruguay agreement is the most ambitious agreement on trade ever taken. GATT would promote transparencies in laws and regulations, treat services from all countries the same, set up dispute settlement and enforcement procedures, and provide for future liberalization through future rounds. In financial services the negotiations are not complete. Many signatories have

reserved their right for an exemption to the MFN provisions of the GATT agreement. The negotiations are not complete because potential signatories have 6 months to bring it back to their country. It is possible that the parties will sign the agreement by January 1, 1995. Parties will continue bilateral negotiations throughout the year.

Globalization will proceed and we should welcome this. We must assure however, that these changes don't make these markets more susceptible to insolvency. It is inevitable that trade procedures will conflict with regulatory procedures. All regulators will be facing decisions in this area sooner than they think. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

**Andre Laboul, OECD
Principal Administrator
OECD**

The share of OECD countries in the world insurance market reaches currently more than 90 percent. It should increase in the near future. In 1994 Mexico became the 25th Member country of the Organisation and other applications are currently under process. The current five concentrations of OECD activities in insurance are related to liberalisation, solvency, monitoring of market and regulatory developments, information gathering and assistance to non-member countries. The following paragraphs summarize the work undertaken since the last meeting in Chicago.

Concerning liberalisation, a joint working Group resumed its activities at the end of 1993. The major objective is to revise the insurance part of the OECD codes of liberalisation and to discuss major liberalisation issues in the insurance field. The work will be supported by a huge data collection on obstacles to trade and services.

On solvency issues, the special working Group created in the beginning of 1993 pursued very actively its work devoted to the examination of national solvency systems and the discussion of major current issues as derivatives, reinsurance (including financial reinsurance) but also equalisation reserves, embedded values, early warning systems, etc.

The monitoring activity of the Insurance Committee allowed for discussions on recent developments in OECD markets as well as on some specific items as health insurance, environment liability, institutional investors, just to quote a few. The Committee discussed also the first draft of a report on policy issues in insurance distribution.

Concerning the data gathering, the work focused both on statistical data collection, with the publication of the insurance statistics Yearbook on 1985-1992 data in June 1993 and on regulatory data collection with the decision to revise the "Paratte" report on supervision of private insurance.

Last but not least, the Committee pursued and developed in 1993 its assistance to Central and Eastern European Countries, organising an informal meeting on Czech insurance regulation at the end of 1993 in Prague and another in Paris on taxation and investment issues at the beginning of

1994 with the four "Partners in transition" (Hungary, Poland, Czech Republic, Slovakia). But the main 1994 event in this field has been the organisation, jointly with the Hungarian supervisory authority, of the First East West Conference of insurance regulators and supervisors, which was held in Budapest in May 1994. The meeting allowed for an in-depth discussion on major policy issues as well as for the setting up of a program of cooperation between OECD Countries and Central and Eastern European Countries and New Independent States.

Report From the Various Regions

Laszlo Asztalos, Hungary, Chair
President
Supervising Authority of Insurance

Adelita A. Vergel de Dios, Philippines, ASEAN
Insurance Commissioner
Insurance Commission

The Association of South East Asian Nations includes six countries. It was established to foster closer cooperation among the member nations for the enhancement of their growth and development. There are 540 insurance companies in the region. Premium earnings totaled 6.3 billion dollars last year. The ASEAN Insurance Commissioners hold annual meetings to provide a forum for an exchange of information on matters of insurance supervision and new developments. Last year the organization underwent structural changes and now meets on a need basis.

A number of projects and activities have been undertaken jointly by the Insurance Commissioners particularly in such areas as education and training, unified insurance statistics, mortality studies, etc. They have also looked into the possibility of harmonizing their insurance laws with the end in view of facilitating greater exchanges in the insurance business and improving the system of insurance supervision as to be responsive to the needs of each country and the region as a whole. Likewise, there are cooperative undertakings with the private sector, one of the most significant milestone of which is the establishment of the ASEAN Reinsurance Corporation. While this has helped considerably in increasing regional retention, however, there is still heavy dependence on reinsurance outside the region. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Alfredo Solloa Junco, Mexico, ASSAL
Presidente

Comision Nacional de Seguros y Fianzas

The Association of Insurance Superintendents of Latin America established a group in response to the penetration of the insurance industry into the Latin American countries. This meant that they need to develop a regional cooperation mechanism. The association formed with the primary objective of exchange among its members and to exchange information on new mechanisms in insurance activity in order to ensure adequate levels of solvency.

To date, ASSAL has conducted four meetings. The first meeting occurred in 1979. The last meeting took place in December 1993. The work of the organization has been in the following areas: a publication of statistical information on insurance in the different countries, and the presentation of manuals and training courses in the member countries. The organization has accomplished the majority of its goals. Other areas that they will cover are harmonization of accounting methods and statistics, regional and subregional programs on insurance and reinsurance training, and agreements between insurers and reinsurers. To strengthen the insurance sector has required a lot of effort.

At present, one can describe the current state of insurance as a watershed. In a number of countries the system changed from concession to authorization. For example, they require minimum capital reserves, there is new treatment of foreign investors, a free system has replaced rate control, antitrust laws are applicable, new, more flexible investment system, and in some situations insurance companies can invest in other countries. Latin America stands as one of the emerging markets that has a tremendous potential for growth.

**Nigel Bailey, British Virgin Islands, CAIR
Insurance Supervisor**

Financial Services Inspectorate

The Caribbean Association of Insurance Regulators (CAIR) became formalized last year with its own corporation and executive council. The objectives of the association are to advocate, encourage, and support the development and enforcement of insurance regulations in the Caribbean, according to worldwide standards. The CAIR designed the committee structure to spread the work.

Each committee represents a key area. There is a conference committee which organizes the annual conference. The Legislative Committee reviews the legislation of the member countries. The Legislative Committee will work closely with the Caribbean Research Institute. The Insurance Fraud Committee looks at ways to combat fraud both from the perspective of the insured and the insurer. The Education Committee is developing a handbook to share with other members in the region. The Executive Council itself takes care of the international relationships. The Executive Council is also working on a directory of its members. The organization will also be working on a database to bring to the reinsurers better statistics on the business of insurance in the region to increase the availability of reinsurance in the area.

**Eigil Mølgaard, Denmark, European Regulators Association
Director General**

Danish Financial Supervisory Authority

The most recent conference of the Association took place last year in Copenhagen. The topics discussed were: the methods for solvency control for non-life companies, reinsurance programs and insurance undertakings and their commitments to employees' pension rights. The association has decided to postpone the decision on whether it will continue to meet in the future in light of the establishment of several organizations including the IAIS.

**Malcolm Butterfield, Bermuda, Offshore Market
Registrar of Companies
Bermuda Government**

The Bermuda insurance industry is a leader in the reinsurance market and is witnessing a substantial amount of growth. The total industry generates 15 billion dollars in gross premiums and eleven billion dollars in net premiums. The perspective from Bermuda is two-prong: formation and administration. In the formation area it is a very detailed program. The question is not just whether a company meets minimum requirements but whether it goes beyond those minimum requirements. There is also a system to respond to the problem companies. If a company becomes insolvent there are provisions for the commissioner to file a petition for winding up. The regulators have prepared to deal with insolvencies.

In 1993 ten property/casualty companies formed and brought with them four billion dollars of reinsurance capacity. There is an ongoing process of reviewing regulations. Confidentiality is important to the offshore jurisdictions and they encourage workings in this area. The attendance of the offshore jurisdictions at IAIS meetings will continue. From a future perspective, capacity, competition and respect are at the forefront of the agenda and the focus in Bermuda will continue to be on quality not quantity.

**Patrick Pearson,
Insurance Division
European Commission**

Eastern Europe is of huge importance to the European Community. The objectives in this area are: to set up a system of aid and assistance to supervisory authorities in these countries, aid in drafting insurance legislation, and organizing seminars and training programs for regulators, supervisors and the insurance industry. There has been a contracting out to experts and consultants to implement these training programs. As evidence of the programs, there is an Insurance Institute in Russia where such programs are being carried out.

Supervision of Financial Conglomerates

**Piet Badenhorst, South Africa, Co-Chair
Executive Officer
Financial Services Board**

Worldwide a trend of increasing concentration in the financial services sector is evident. The primary reasons appear to be: attempts to gain economies of scale against reduced profit margins, a trend towards globalization of business activities, structural changes in the traditional markets in terms of products required and the level of sophistication, and technological advances that facilitate the process. Generally speaking present legislative regimes have not allowed for the merging of the traditionally distinct financial institutions. The trend has manifested itself with the coming into being of groups of companies, each servicing a separate area, with intra-group transactions sometimes predominating.

One can describe a financial conglomerate as any group of companies under common ownership where they undertake financial activities on a significant scale by any one or more companies in the group. The International Organization of Securities Commissions (IOSCO) holds that although consolidated supervision is generally of concern, it is of more concern in those groups where securities business is the major part of its business or forms a significant part thereof. The focus of consolidated supervision is wider than individual participants and their activities, to the institution in the context of the group of which it forms part.

Supervisors have removed barriers between themselves to facilitate consolidated supervision, enabling them to effectively cope with the added responsibility. The actual consolidated supervision approach is from the basis of three perspectives (group based risk assessment, investments in other group companies, intra group exposure), in respect of the formulation of a number of guiding principles.

Although the EEC has made headway in introducing consolidated supervision, their system is not final. They still need to address several issues including: the role and responsibility of the auditors for the group or at least for the financial conglomerates, the necessity of having the same auditors for the group or at least for the financial institutions in the group, and the necessity for full and consolidated reporting of financial results.

The IOSCO points out that most regulatory approaches have been on a solo basis regulating individual institutions on an institutional basis and point out that such regulation does not take cognizance of the consequences that could follow a significant failure in the group, and they particularly identify the securities area as an area of concern. From their analysis IOSCO identifies the following principles to guide consolidated supervisory approaches: group based risk assessment should take place when intra-group exposure is apparent; where a regulated company has provided regulated capital to another group company, regulations should apply thereto; intra-group exposures should be monitored by the regulator; corporate and managerial structures should be understood by the regulator and should not hamper supervision; shareholders should be susceptible to regulatory influence and should meet fitness standards;

management should meet fitness standards; regulators should be able to cooperate and should actively do so; and the role of the auditor is significant and must be clearly defined so as to ensure that concerns are brought to the attention of the regulator.

South African financial services sector has grown substantially. Presently the financial services sector is heavily concentrated with a few groups of companies of varying degrees of affinity effectively controlling the sector. Supervision is primarily on an institutional basis and moves towards functional and consolidated supervision and underway but not yet fully established.

The primary focus of consolidated supervision is: fit and proper shareholders, expertise at board and management level, solvency in the group, concentration of power, conflicts of interest, corporate structure and transparency, dispersion of management control, risk areas in the group, e.g. capital adequacy, large exposures, double gearing and contagion risks, and effective auditing of the group as a whole. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Dr. Jonathan Spencer, United Kingdom, Co-Chair
Head/Insurance Division
Department of Trade and Industry

The simplest form of a financial institution is a single free standing insurance company, bank or securities house. Other forms include insurance groups in which more than one insurance company falls under the same ultimate common ownership. Another form is the one in which one insurance company owns one or more than one insurance companies -- which may or may not all be domiciled in the same territory as the parent. The international debate on financial conglomerates has focused on wider financial groups which do not simply contain a collection of insurance companies but which include more than one different financial discipline. In the U.S.A and Japan there are long standing impediments in developments of this type. In the main European countries and in many other countries around the world such impediments do not exist.

The main issues identified in supervising financial conglomerates include: transparency of group structures, access to information on the part of the supervisors, management autonomy, contagion, intra-group exposures, and group surveillance of capital adequacy/double gearing.

The UK has been the headquarters for many years for large and complex international banking groups and insurance groups, and it is therefore not surprising that over the years appropriate supervisory techniques to deal with these complexities have developed.

The list of supervisory bodies interested in the issue include: EC Insurance Committee and Banking Advisory Committees, EC Conference of Insurance Supervisors, OECD, the IOSCO Technical Committee, the Basle Committee of Banking Supervisors, and the informal Tripartite Group of Securities, Insurance and Bank Regulators. There is not uniform agreement in relation to the appropriate techniques for assessing capital adequacy in financial conglomerates, and related financial requirements. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Piet Keizer, Netherlands

Secretary

Verzekeringskamer

The formation of complex conglomerates in which banking and insurance activities, in particular, have been incorporated, raises the question as to what system of supervision should be used for such conglomerates. There are three main types of supervision of financial conglomerates: solo supervision, consolidated supervision, and solo-plus supervision. Solo supervision concentrates on the characteristics of the financial institution under direct supervision. An insurance supervisor supervises the adequacy of the technical reserves, the solidity and spread of the company's investments in relation to the technical reserves, the valuation of the investments, the size of the shareholders' equity in relation to the required solvency margin and the reinsurance components.

In certain cases solo supervision is inefficient and equally ineffective. In that case consolidated supervision may be the more appropriate form of supervision. This is particularly so in cases where the economic group in question is more or less closed and well-defined, and consists of a number of fairly homogeneous components linked to a holding company which has an explicit directive function.

Complex relationships often characterize large, modern insurance groups. In this case a solo plus supervision may be the more appropriate form of supervision. The particular importance and the nature of the interrelationships referred to demands a "plus," a broadening of the supervision. The solo-plus approach as a matter of principle takes into account a number of relevant perspectives or facets which result from the complicated nature of the conglomerate in question.

In the Netherlands there are agreements between the supervisors of the banks and insurers with regard to financial conglomerates. These agreements are based upon the solo-plus model. The recently renewed Protocol states these agreements. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Insurance Issues in Developing Countries

Adelita A. Vergel de Dios, Chair

Insurance Commissioner

Insurance Commission

The Association of South East Asian Nations includes six countries. It was established to foster closer cooperation among the member nations for the enhancement of their growth and development. There are 540 insurance companies in the region. Premium earnings totaled 6.3 billion dollars last year. The ASEAN Insurance Commissioners hold annual meetings to provide a forum for an exchange of information on matters of insurance supervision and new developments. Last year the organization underwent structural changes and now meets on a need basis.

A number of projects and activities have been undertaken jointly by the Insurance Commissioners particularly in such areas as education and training, unified insurance statistics, mortality studies, etc. They have also looked into the possibility of harmonizing their insurance laws with the end in view of facilitating greater exchanges in the insurance business and improving the system of insurance supervision as to be responsive to the needs of each country and the region as a whole. Likewise, there are cooperative undertakings with the private sector, one of the most significant milestone of which is the establishment of the ASEAN Reinsurance Corporation. While this has helped considerably in increasing regional retention, however, there is still heavy dependence on reinsurers outside the region.

Dr. Marion Gallis-Quednau, Switzerland, UNCTAD

Chief, Insurance Program

UNCTAD

Of the many challenges faced by insurers in developing countries, none equals that generated by the privatization and liberalization of their markets. Both are fundamentally changing the structure of insurance markets in developing countries.

A primary goal of privatization is usually to provide quality products at more competitive prices. But apart from the difficulties of privatizing large public insurance and reinsurance monopolies it must be recognized that it is market structure rather than ownership which is the decisive element for competition and efficiency. Due to scarcity of local capital and domestic investor's hesitation to go into such long-term activities as insurance, only a market liberalization that opens the door to foreign insurers can often achieve the desired degree of competition.

Negotiations on the global liberalization of insurance markets have stressed the benefits that greater market access would bring to suppliers of both developed and developing countries.

However, Third World insurers may at this stage not gain much from a market opening in developed countries. Physical presence of the insurance provider is usually needed to sell cover. But capital and/or solvency required in developed countries for the establishment of subsidiaries or branches are usually considered prohibitively high by developing country insurers. When it comes to large and target risks for which cover could be offered cross-border via brokers,

developing country insurers continue to rely heavily on international markets even for those risks that emanate from their own domestic activities.

When opening their own market to foreign suppliers, the competitive position of developing country insurers is compromised by the fact that they have neither the same capitalization as foreign companies, nor the same skill basis and technical expertise, nor the foreign exchange resources required in this trade.

Many developing country consumers would for example want to buy their life insurance in a hard currency country, even when domestic insurers offer quality life products. At the same time, large foreign companies established on their domestic markets could effect a kind of dumping through the income they achieve on their capital funds and by subsidizing initial operations in developing countries from gains in other countries.

A quick and full-scale liberalization of insurance markets might therefore wipe out the progress that developing countries have achieved during recent decades. Irreversible losses of capital, labor skills and technological capabilities may be the result. A well-planned step-by-step approach is therefore advisable. Liberalization measures should be accompanied by selective incentives to companies exposed to foreign competition, and by congruent wider policy measures that create a favorable climate for expansion and growth. Only an improvement of the macro-economic environment in which developing country insurers work would provide them with a level playing ground in respect to competitors from the developing countries. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Potjaneer Thanavarant, Thailand
Department Specialist (Non-Life Insurance)
Department of Insurance

The developing countries have already established regional reinsurance organizations. These reinsurance organizations, however, need capital. What they now need is support to increase their capital base and operations. Insurance companies continue to be among the biggest investors and hence play a wide role in the economies of developing countries. Thus this issue remains of paramount importance although there are still differences among them on how to achieve the objectives as they shift from protectionism to liberalization.

In many countries, both developed and developing, insurance markets have been subject to a multitude of restrictions and non tariff barriers which makes it difficult for a non-domestic insurer to do business. This has been the topic at the Uruguay Round. The principle of market access has two sides: foreign markets are to be opened to a country's own service industry and it has to open its own market to foreign providers of a service. The apprehension is there that once the door is opened the developing countries concerned might be subject to more pressures which may be difficult to resist. As supervisors, we must give developing countries a period of time to compete when it comes to the time of the full liberalization of the insurance market.

Laszlo Asztalos, Hungary
President

Supervising Authority of Insurance

The region that is being covered includes twelve countries varying in size. In most of the countries there is insurance legislation in place, however, some countries are in the process of amending their existing laws. None of the countries have insurance legislation regarding insurance contracts. All of the countries have a law or a decree regarding compulsory or third party motor liability. In three countries there are laws on consumer protection. Only a few countries regulate intermediaries brokers, and/or mutual funds. It is realistic to wait for more development and specialization in insurance in these countries. In most of the countries, international guidelines and rules are essential in helping with modernization. In the area of export credit insurance, only a few countries have companies, however, all of them are state owned. There are no projects in the works to privatize in the area of export credit insurance.

It is typical to offer an exclusive license for insurance, and there are minimum capital requirements that vary widely. A stock company is the typical form of an insurance company. Compulsory insurance is a flourishing area and only in some countries are the roles of actuaries regulated. Regulators have discussed the topic of winding up, however, there is no agreement where to put regulations concerning winding up. Some countries had provision for funds to protect insureds. There is a real tendency in all the countries to widen the space between the insurance supervisory body and the Ministry of Finance. The states finance most bodies. In some countries, the industry contributes to financing. Now is not the time to establish a regional organization, but there is agreement to establish a system to exchange information and a directory of the regional supervisors.

Stephen Ip Shu-kwan, Hong Kong
Commissioner of Insurance

Office of the Commissioner of Insurance

Hong Kong has a very open market. The problem in Hong Kong is that insurance companies will no longer provide unlimited reinsurance cover to the direct insurers in respect to motor third party liability and employees compensation insurance. Hong Kong law required motorists to take out insurance (unlimited liability) and employers to take out employee compensation insurance (unlimited liability). Now that reinsurers have decided not to provide unlimited reinsurance cover, the direct insurers will have trouble complying with the statutory requirement of unlimited liability. One solution is to specify a minimum liability that one must insure instead of unlimited liability.

Yahaya Besah, Malaysia

Insurance Department

Bank Negara Malaysia

One of the main issues that confronts Malaysia is the unprofitable nature of motor insurance. Because motor insurance is compulsory and there are a high number of claims, the motor insurance sector is unprofitable. Another issue facing the Malaysia insurance industry is the high cost of insurance. Excessive commissions and fringe benefits have caused the banks to put in place price controls. Another problem is the high reliance on overseas reinsurers. Excessive reliance on overseas reinsurance makes the Malaysian insurer very vulnerable to the market in the overseas countries. This causes the outflow of funds -- out of the country. In order to create greater participation in the domestic reinsurance market the Malaysian government has allowed foreign reinsurers to participate in the local market. Incompetent management causes most insolvencies. In the area of human resources, employee development is essential to the growth of the insurance industry. Training of insurance staff is a major concern and regulators need to address it in order to strengthen the industry. Regulators instituted programs to enhance the training of the staff. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Catastrophic Risks

Alfredo Solloa Junco, Mexico
Presidente

Comision Nacional de Seguros y Fianzas

Catastrophes fall into two groups: natural and man made. Natural catastrophes include flood, storms, earthquakes and volcanic eruptions. Man made catastrophes include fires, aviation, waterborne traffic, road/rail and other epidemics. The variables to measure catastrophes are frequency and magnitude. In general catastrophes are on the increase and natural catastrophes occur more frequently than man made catastrophes. Hurricane Andrew resulted in damages from natural catastrophes being higher than the damages from man made catastrophes. There are noticeable reasons why losses are now greater. This is due to an increase in population and the immediate nature of the most recent catastrophes. In light of the increase in catastrophes the insurance industry needs to look at ways of spreading the risks.

Because of its location Mexico is an easy target for catastrophic events. Mexico divides into five areas based on the risk of a catastrophe occurring. In those areas where there has not been a catastrophe in many years the likelihood of a more severe earthquake in the future rises. Mexico City is particularly vulnerable. Currently, a fund is being looked into that could help pay for some of the losses that will arise if such a catastrophe were to occur in the future.

Clyde W. (Billy) Galloway, Jr., Florida
Bureau Chief

Property & Casualty Solvency and Market Conduct

Hurricane Andrew was the worst natural catastrophe that has hit the state of Florida. The hurricane was a vivid reminder that the most important part of the industry is the service that it offers its customers. Tasks such as passing out water, food, and medical care were the first things that needed taking care of before homeowners dealt with insurance questions. Other considerations presented with the hurricane was the stabilization of the market when a catastrophe hits. The direct market was destabilized when the catastrophe occurred. The regulators realized the need for certain rules that need to be in force for when a situation like Hurricane Andrew arises. For example, rules regarding withdrawal and renewal of policies need to be in force. Another aspect realized was the importance in the collection of data, specifically exposure data. Overexposure of companies was the factor that led to the demise of several insurance companies in Florida. In response, the surplus requirements increased for smaller companies. Now, small companies will not be able to enter a market that is prone to huge losses. Another response is a fund that works as a reinsurance fund to help companies that suffer huge losses and as a result jeopardize their surpluses. In short, when a disaster goes beyond the regulatory body that exists then one needs to be creative in order to deal with the loss.

Jean-Louis Bellando, France
Commissaire Controleur General
Commission de Controle des Assurances

By luck and perhaps location, there have been no major catastrophes in France. The system in France, therefore, is unique to the French situation. Thus this system may be good for France but not for other countries. Before 1982, French insurance policies would exclude catastrophes due to lack of statistics and other information. It is difficult to get the public to purchase catastrophic insurance because catastrophes such as earthquakes are not common in the area. In Nice, for example, an earthquake occurs perhaps once every thousand years and, if personal possessions were to be guaranteed in the event of an earthquake, premiums for insurance against loss or damage would double.

In France, the solution has been to share the various catastrophic risks. For quite a long time, agriculture disasters have been covered by a specific system, farmers pay half of the claims, the other half being financed by government subsidies. As for other risks, the solution consists of requiring mandatory coverage for natural disasters and the state helps control the rates. If you choose to insure your possessions against fire and other damages then you must obtain natural disaster insurance. The premium includes a surcharge that represents the additional coverage. The surcharge ranges from 5-10%, and the state decides the percentage. Those insurance companies that provide natural catastrophe coverage, can get reinsurance from a government-controlled reinsurance company, la Caisse centrale de reassurance. Natural disasters do not include storms and one must insure themselves against storms in their primary coverage. In the area of storm damage, there are enough statistics so that regulators can calculate the premium. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Takaatsu Sumikura, Japan
Deputy Director of the Second Insurance Division
Ministry of Finance

The earthquake exposure in Japan was too large for private insurance companies to write the risk and also very difficult to calculate appropriate premium, since frequency and damageability of earthquake is volatile. Following a large earthquake in Niigata in 1964, the demands for earthquake insurance increased and an earthquake insurance program was established in 1966 to help the people to recover their daily lives. The primary layer of this program is retained by the private insurance companies and the Government provides Excess of Loss Reinsurance capacity to them. The total amount covered under this program moves parallel to the Probable Maximum Loss of earthquake insurance, and current limit is 1.5 trillion Yen for any one earthquake. The premium rate for the program is calculated on "No loss and no profit (to insurers)" principle, as the character of this program is highly public. For in case a large earthquake loss exhausts the latest premium fund, the Government is ready to loan from the National General Budget.

Eduardo Aguilar Fernandez-Hontoria, Spain

Director General

Dirección General de Seguros

Spain has been a country of moderate exposure to catastrophic risk. At the same time, it has been a country with years of stability in this area. Spain is a country of varying conditions. The country divides into three distinct zones that differ in their topography. Spain is also subject to human catastrophic events such as terrorism. The consortium established has three advantages: it allows for the coverage of excessive risks, also works in regards to covering certain risks affecting industrial, economic and personal losses, and stabilizes the coverage of risk totally independent of any political or budgetary decision. This third advantage is probably most important because there is a minimum guaranteed through the system. The system works through reinsurance in so far as the premiums calculated through the consortium are charged through different insurance schemes. This provides a triple advantage: the consortium is neutral, it bases the premium on capital as guaranteed by the insurance company in the coverage of risk, and the consortium must show an accounting statement. Statistics show that 85% of the catastrophes are due to floods. The reason for setting up the consortium was to protect the industrial sector. The consortium allows for a spreading of the risk and the financing is simple.

Richard Roth, California

Department of Insurance

California has the greatest chance of being hit by an earthquake than any other state in the United States. Regulators send out questionnaires to find out how many earthquake policies are in force in the state and the type of buildings that are being insured. The questionnaires depict a number of trends. The amount of earthquake insurance has increased dramatically. Almost half the homes have earthquake insurance at this time in California. The demand for earthquake insurance follows the increase in earthquake activity. There have also been trends in reinsurance. Insurers cannot sell commercial earthquake insurance without reinsurance. The problem is that earthquake insurance demand is increasing and the corresponding worldwide reinsurance market is not.

In addition to the routine questionnaire, regulators send another questionnaire after every earthquake. Soil was a major factor in the San Francisco earthquake. Thus analyzing the soil is more important sometimes than the structure of the building itself. The state enacted a program that would help pay the high deductible that was common in most policies. The problem with this program was that it led to thousands of claims being filed for small amounts. Regulators terminated the program at the end of one year. It was an expensive program just due to the costs of collecting fees and other administrative costs. California has also been the victim of fires. Fires, however, usually result in total losses where earthquakes result in only partial loss. Fires therefore raise problems with replacement costs. (Full text available from the IAIS Secretariat, NAIC/Kansas City.)

Questionnaire on the Memorandum of Understanding

**Nigel Bailey, British Virgin Islands, Chair
Insurance Supervisor**

Financial Services Inspectorate

Communication has been the biggest problem in the area of exchange of information. Confidentiality also raises problems for many countries. The IAIS needs to discuss whether we should develop our database of information now, or some time in the future. Feedback is another key factor in encouraging the exchange of information.

Fifty-five out of 77 IAIS members answered the questionnaire. Fifty-two countries are able to pass on information to regulators. Of the 52 countries, 17 countries can pass information without limitation. Fifteen countries can pass on information if the requester keeps it confidential. Generally speaking, annual reports and accounts are available. In a large number of cases all types of information are available. Most countries produce information annually and most countries provide information on a compulsory basis. Most countries regulate reinsurance. Out of the 55 responses, 47 countries responded that there are no difficulties in obtaining information, however, several countries cited lack of speed as a typical problem in obtaining information. Suggestions included relaxing barriers for sharing information and introducing offshore legislation.

**Jean-Marc Delporte, Belgium
President**

Office de Controle des Assurances

The third directives implemented July 1 in the European Union include a secrecy provision. It does not prevent exchange of information, but subjects the exchange of information to a number of conditions. These conditions are: 1) the requester can only use the information in the course of business, 2) or to impose sanction 3) or for an administrative appeal, or 4) for court proceedings. Countries can arrange to exchange information as long as they keep it confidential. If the IAIS adopts the recommendation, they need to keep in mind the third directives that are in force as of July 1, 1994. For next year's conference it might be of great importance to compile a listing of all the secrecy laws in force in the member countries.

**John Thompson, Canada
Deputy Superintendent**

Office of the Superintendent of Financial Institutions

At the federal level in Canada, regulators must keep confidential all the information held in carrying out the business of insurance. Any exceptions to the general rule are time-consuming, limited, difficult and require the permission of the minister. This is not desirable for the long term. In Canada, insurance companies are subject to provincial law as well as federal law. The federal regulators and the provincial regulators have established confidentiality agreements. No agreements are in force at the present time with foreign regulators, although there have been exchanges in the past.

The good relationship established between the regulators in Canada and the insurance companies stems from the fact that each party has kept information confidential. This good relationship has been helpful to the insurance industry. Thus the confidentiality laws have helped the regulators in Canada keep the lines of communication open with the industry itself. Thus Canadian regulators feel that if they exchange information with a foreign regulator the other party should keep it as confidential as one would in Canada. When a foreign regulator gives a Canadian regulator information, they keep it confidential. Canada is willing to enter into arrangements with those countries that are willing to adhere to the same level of confidentiality found in Canada.

Lester Dunlap, Louisiana

Department of Insurance

Louisiana has implemented a number of practices. One of the practices is relevant to the exchange of information which is open communication. There has also been an active outreach to sister insurance departments which helps detect some of the fraud problems that have plagued the Louisiana insurance department. The next step that the commissioners in the United States need to take is to work together with insurance departments from other IAIS members. Communication is the best facilitator in the exchange of information.

Michael Constantine, Gibraltar

Acting Financial Services Commissioner

Gibraltar Financial Services Commission

Gibraltar is a self governing jurisdiction. Gibraltar enacted an insurance law in 1987 and continued to update the law. There are specific provisions regarding secrecy in Gibraltar. The insurance supervisor can disclose information 1) to another insurance supervisor of any member state or authority if that person appears to be the supervisor of the respective insurance department and, 2) where such disclosure is in the interest of detecting crime. If a regulator in Gibraltar receives information, in practice, the regulator will not pass that information onto a third party without express permission. It is also a practice that the insurance department responds to any request made for information within twenty-four hours.

Offshore Round Table

Steve Butterworth, Guernsey
Superintendent of Insurance Business
Guernsey Financial Services Commission

The majority of concern for most insurance supervisors is with a home country's policyholders and not necessarily with the policyholder abroad whereas the offshore supervisor must have a special regard for the overseas policyholder. Scandals that mention offshore jurisdictions have the practical effect of giving a bad image to all of the offshore jurisdictions. The regulatory characteristics that an offshore jurisdiction usually has are:

- 1) small in size
- 2) supplemental solvency based approach to supervision with preferred risk based approach
- 3) capital and solvency requirements that are flexible (in general it is not true that there are no restrictions in this area).

The objective of the offshore jurisdiction organization (OGIS) is to bring together insurance supervisors from those offshore territories which have established proper regulations and to provide mutual assistance and encouragement to other territories to meet equivalent standards. In order to be a member one must go through a period in which the jurisdiction demonstrates that the proper legislation and resources and the ability to exchange information to carry on the business of insurance are in place. The strategy has been to work toward those objectives.

Colin Holder, Turks & Caicos
Superintendent of Insurance
Offshore Finance Centre Unit

The "Thorton" insurance scam is exemplary of the efforts of the Turks & Caicos to clean-up the bad image that plagued many offshore jurisdictions. Thorton set up his company in the TCI and sold policies in the United States. Regulators alerted the TCI police to the scam. The United States enforcement authorities and the BVI authorities also became involved in the ferreting out of this scam artist. Thorton's conviction provides an excellent example of how cooperation between regulators can lead to the discovery of insurance scams. Many offshore jurisdictions have legislative provisions that allow the exchange of information and the flexibility of confidentiality laws. A responsible attitude is essential for repeated cooperation in this area.

John Darwood, Cayman Islands
Deputy Inspector
Cayman Islands Government

How do well supervised offshore centres benefit their on-shore neighbours?

A well supervised offshore centre may provide a number of benefits to its offshore neighbours; the nature of the benefits will be varied somewhat depending upon the business involved.

Firstly, a well supervised offshore centre will provide a stable, well regulated, well managed and comfortable environment in which to do business. The centre will have a "user friendly"

regulatory system which caters to all financial disciplines - investments, banking and insurance. Advantages to the user may include a low level of ability to construct and operate insurance vehicles which are responsive to corporate insurance needs in respect of which no coverage is readily available elsewhere, or where the economics of the operation are much more favorable than obtainable on-shore.

From the user's perspective the well supervised offshore centre will provide an abundance of well regulated services, from Alphabet house brokers/mangers, major accounting firms, full banking and investment services.

Insurance programs, utilizing offshore insurers, can be constructed which substantially assist in the financial management of all sorts of businesses, ranging from automobile manufacturing to the production of conventional and atomic power to the provision of health care services. In all of these spheres of activity the on-shore consumer is one of the beneficiaries. Often such ventures require substantial investment, and a risk manager proposing such investment will certainly have to convince his principals that the proper controls and safeguards are in place - no satisfaction - no investment! In some cases the offshore vehicle may provide the only means of obtaining any sort of reasonably priced coverage, for instance in the area of catastrophes - wind and earthquake. There are many businesses around the Caribbean which would have very inadequate catastrophe cover were it not for offshore facilities. In a broader sense the development of very substantial new reinsurance facilities offshore is another evidence of the benefit to the insurance industry generally.

Mention of these new reinsurance facilities causes me to digress for a moment to contemplate the ways in which the offshore insurance activity has changed for the better over the last few years. Given the much higher standards of current regulation, both on and off-shore, entrepreneurial operators similar to those who have caused many problems in the past are not nearly so likely to find a foothold. The proportion of the offshore operators involved in direct insurance in the US Surplus Lines Market has shrunk dramatically and that reduction has been balanced by the entry of many more substantial and reputable participants.

Secondly a well supervised offshore centre will have a supervisory authority which will be ready to properly relate to all the on-shore jurisdictions in which its licensed insurers operate. It is significant to note that nearly all the offshore jurisdictions are IAIS members, and also members of the International Association of Insurance Fraud Agencies, and their commitment to the cause is demonstrated by a nearly two week session of meetings here in Baltimore. Information exchange, as already discussed this afternoon, is already an established process. One advantage an offshore regulator has over his on-shore counterpart is that he is able to closely monitor the affairs of his licensees, either directly or through local insurance managers; it is a very "hands on" function.

Finally, may I say how disappointed I am to hear that our US brethren are embarking on what seems very much like a witch hunt in compiling a dossier on unsatisfactory experiences with offshore insurers. This seems to indicate they are still failing to appreciate the substantial and significant changes for the better which I and my colleagues have tried to emphasise.

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

**Financial Statements for the
Year Ended December 31, 1994,
and Independent Auditors' Report**



INDEPENDENT AUDITORS' REPORT

The Honorable Members of the
International Association of Insurance Supervisors

We have audited the accompanying balance sheet of the International Association of Insurance Supervisors (the "IAIS") as of December 31, 1994, and the related statements of revenue, expenses and changes in fund balance and cash flow for the year then ended. These financial statements are the responsibility of the IAIS's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the IAIS as of December 31, 1994, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

April 24, 1995

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

BALANCE SHEET DECEMBER 31, 1994

ASSETS

CASH AND CASH EQUIVALENTS	\$ 72,199
ACCOUNTS RECEIVABLE	<u>11,200</u>
TOTAL ASSETS	<u>\$ 83,399</u>

LIABILITY AND FUND BALANCE

LIABILITY - Accounts payable	\$ 10,461
FUND BALANCE	<u>72,938</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 83,399</u>

See notes to financial statements.

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

STATEMENT OF REVENUE, EXPENSES AND CHANGES IN FUND BALANCE YEAR ENDED DECEMBER 31, 1994

REVENUE:

Membership fees	\$ 86,968
Meeting registration fees	36,300
Interest income	<u>1,669</u>
Total revenue	124,937

EXPENSES:

Translation services	17,892
Administrative	12,554
Telephone	9,693
Meeting	8,362
Professional services	2,163
Postage	1,177
Other	<u>158</u>
Total expenses	<u>51,999</u>

EXCESS OF REVENUE OVER EXPENSES	72,938
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FUND BALANCE, BEGINNING OF YEAR	<u> </u>
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FUND BALANCE, END OF YEAR	<u>\$ 72,938</u>
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See notes to financial statements.

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

STATEMENT OF CASH FLOW YEAR ENDED DECEMBER 31, 1994

CASH FLOWS FROM OPERATING ACTIVITIES:	
Revenue in excess of expenses	\$ 72,938
Adjustments to reconcile revenue in excess of expenses to net cash provided by operating activities:	
Increase in accounts receivable	(11,200)
Increase in accounts payable	<u>10,461</u>
Net cash provided by operating activities	72,199
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u> </u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 72,199</u>

See notes to financial statements.

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

NOTES TO FINANCIAL STATEMENTS YEAR ENDED DECEMBER 31, 1994

1. ORGANIZATION

The International Association of Insurance Supervisors (the "IAIS") is an organization of and for the international insurance supervisory officials. The IAIS provides an independent forum for these officials to promote cooperation among the members in carrying out their responsibilities and to enhance their ability to protect insurance policyholders and promote secure and efficient insurance markets.

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents includes deposits in a checking account and an interest bearing money market account.

3. BASIS OF ACCOUNTING

Membership fees are recorded as revenues in the applicable membership year. Revenues and expenses for meetings are recorded when earned or incurred.

4. INCOME TAXES

The IAIS has applied under section 501(c)(6) of the Internal Revenue Code for Federal Income tax exempt designation. No provision for income taxes has been made as it is management's opinion that the IAIS will be granted tax exempt status for the year ended December 31, 1994.

5. RELATED PARTY

The National Association of Insurance Commissioners (the "NAIC") is a member of the IAIS. Under a Services Agreement between the NAIC and the IAIS, the NAIC provides certain administrative and consulting services to the IAIS. For the year ended December 31, 1994, the total amount charged by the NAIC for administrative time was \$12,554. As of December 31, 1994, the IAIS had amounts payable of \$8,381 to the NAIC for services rendered or expenses paid by the NAIC on behalf of the IAIS.

6. NEW ACCOUNTING STANDARDS

In June 1993, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 116, *Accounting for Contributions Received and Contributions Made*. SFAS 116 establishes standards for contributions and applies to all entities that receive or make contributions. SFAS 116 provides guidance on the recognition of contributions, including time-phased pledges and conditional promises to give. The statement is effective for financial statements issued for years beginning after December 15, 1994, except for not-for-profit organizations with less than \$5 million in total assets and less than \$1 million in annual expenses for which the effective date is for the

years beginning after December 15, 1995. Management of the IAIS does not anticipate a material impact to the financial statements from adopting this statement.

In June 1993, FASB issued SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*. SFAS 117 establishes standards for general-purpose external financial statements provided by a not-for-profit organization. SFAS 117 requires that all not-for-profit organizations provide a statement of financial position, a statement of activities and a statement of cash flows. In addition, all not-for-profit organizations must classify net assets, revenues, expenses, gains and losses in three classes: permanently restricted, temporarily restricted and unrestricted. The statement is effective for financial statements issued for years beginning after December 15, 1994, except for not-for-profit organizations with less than \$5 million in total assets and less than \$1 million in annual expenses for which the effective date is for the years beginning after December 15, 1995. Management plans to adopt this statement for its year ending December 31, 1996.

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IV. List of All Members of the Association (Charter Members, Members, and Observers)

1. Charter Members

Anguila	Nepal
Argentina	The Netherlands
Aruba	Norway
Australia	Panama
Austria	Papua New Guinea
Bahamas	Paraguay
Belgium	Peru
Belize	Philippines
Bermuda	Poland
Bolivia	Portugal
British Virgin Islands	Russia
Canada, Federal	Senegal
Cayman Islands	Singapore
Chile	Solomon Islands
Colombia	South Africa
Denmark	Spain
Ecuador	Sri Lanka
Egypt	Sweden
El Salvador	Switzerland
Fiji	Taiwan R.O.C.
Finland	Thailand
France/Commission de Controle	Tunisia
France/Ministere de L'Economie	United Kingdom
Germany/Aufsichtsamt	USA
Germany/Bundesmin d Finanzen	Alabama
Ghana	Alaska
Gibraltar	California
Guatemala	Florida
Guernsey	Georgia
Hong Kong	Illinois
Hungary	Iowa
Iceland	Louisiana
Ireland	Maine
Isle of Man	Michigan
Israel	New Jersey
Italy	New York
Japan	Texas
Jersey	Utah
Korea, Republic of	Vermont

Luxembourg
Macau
Malaysia
Malta
Mexico
NAIC

West Virginia
Venezuela

2. Members

Turks & Caicos
Mauritius

3. Observers

European Commission