# The evolving US regulatory landscape

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ViewPoints
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## The evolving US regulatory landscape

For most of the history of modern insurance, regulation has been a local affair, shaped by the laws, conditions, and customs of specific geographies. In the United States, this meant a regulatory regime focused at the state level, with few provisions for group or consolidated supervision. This regulatory structure endured even as insurance groups reached beyond local boundaries to become multinational and global. The disparity between regulatory and corporate structures came to a head in the 2008 financial crisis, when subsidiaries threatened the solvency of groups and, in some cases, the stability of the financial system.

Though several years have elapsed since the crisis, group-level capital standards are now coming to fruition. In the United States, the National Association of Insurance Commissioners (NAIC), the organizing body for state insurance regulators, and the Federal Reserve (Fed) are each making significant progress in developing approaches to group-level capital for US-based insurers. At the same time, a parallel process is under way through the International Association of Insurance Supervisors (IAIS) to set a minimum global standard for group-level capital. Depending on their final form and how well different standards align, the new capital rules are likely to improve group oversight and solvency but may also have important implications for product availability and cost.

While leading insurers and supervisors are keen to settle the question of appropriate group-level capital, several IGLN participants noted that this is still, in the words of one director, *"fighting the last war."* Beyond this, many IGLN participants see rapid structural change in the insurance industry and said that regulation, like insurance itself, will have to become more adaptive.

On June 1, industry participants, along with key policymakers and supervisors including representatives from the Federal Insurance Office, the NAIC, and the Fed, met in New York to discuss the evolving US regulatory landscape. For a list of meeting participants, see Appendix 1, on page 13. This *ViewPoints*[1] provides a summary of these discussions and centers on three key themes:

- **US supervisors are making progress in modernizing domestic capital regimes, but obstacles remain**
- **Despite some challenges, the international standards development process is moving forward**
- **Unprecedented external dynamics are forcing industry and supervisors to adapt**

## US supervisors are making progress in modernizing domestic capital regimes, but obstacles remain

*"I believe we are at the beginning of the end of regulatory uncertainty on group capital,"* suggested one supervisor. For many insurers wary of constantly shifting regulatory goalposts, this is a welcome development. First, the NAIC has convened a working group to establish a group capital methodology that would apply to US-domiciled, internationally active insurance groups. While the NAIC has not set a firm timeline, its working group is expected to continue to make progress in the coming months. The Federal Reserve has also proposed standards for the 14 insurance-related institutions under its purview, which include systemically important insurers and those that have savings and loan holding companies within the group. In total, Fed supervision accounts for $2 trillion in assets and about 25% of the US industry.[2]

*"The stakes are high. A lot is happening on capital right now, with much to work out."*
– Participant

In May and June, the Fed offered its first guidance on forthcoming capital regulation, and it has requested comments on two sets of proposed rules by August 17. The first proposed rules outline two conceptual approaches for capital requirements: one would govern systemically important financial institutions (SIFIs) and the other would govern savings and loan holding companies (SLHCs).[3] The second proposes enhanced prudential standards for systemic firms related to corporate governance, risk management, and liquidity.[4]

### The Fed and NAIC are each developing a capital aggregation approach

Both the Fed and NAIC favor an aggregation, or "building blocks," approach to group capital for non-systemic insurers, which would aggregate capital across legal entities to calculate a combined group-level requirement. Qualifying capital levels for each subsidiary would be determined by the subsidiary's regulator, whether a state or foreign authority. Both the NAIC and the Fed suggest this approach has a relatively low regulatory burden.

*"If [the group capital calculation] is not going to be an actual law but a supervisory tool, then how will that work in practice?"*
– Director

David Altmaier, chairman of the NAIC panel on group capital, described the NAIC's aggregation calculation as a supplement to other regulatory tools that will build on existing legal-entity capital requirements rather than developing new or additional standards; it will not involve a group capital standard or require states to adopt a model law.[5] Somewhat in contrast, the Fed has described its building-block approach as a standard, albeit one that is far less complex than the proposed standard for systemic insurers.

In discussion, IGLN participants raised three challenge areas that must be addressed through implementation:

- **Consolidated assessments are new and untested.** Several participants agreed with one who said, *"The concerns about the aggregation approaches are very basic. It has never been done before. US insurers have never had to pull together their life and property and casualty operations."* Because this is an untested process, participants have concerns about how the mechanics may work, the expense and learning curve for companies, and the unanticipated problems that may arise simply because all parties are learning as they go.
- **Accounting for intercompany transactions.** Participants described transactions between subsidiary companies or between parents and subsidiary companies as particularly challenging. In an aggregated framework, some intercompany transactions could generate

redundancies in capital requirements. Many directors cited the importance of eliminating double counting in order to maintain an efficient capital regime and to ensure a level playing field. Conversely, some transactions may artificially reduce required capital without commensurate risk reductions. The Fed has noted the potential for double leverage when an upstream entity issues debt to acquire a stake in a downstream entity. Noting the widespread use of captives to self-insure and reduce capital requirements, one supervisor said, *"We have concerns that one-third of the industry surplus is tied up in affiliate-owned captives."* Any aggregation approach will need to account for intercompany transactions, which is likely to result in extensive adjustments.

- **Addressing variations in local capital requirements.** Implementation of the building blocks approach will require careful consideration of jurisdictional differences. Aggregation alone, without careful balancing among jurisdictions, could lend itself to regulatory arbitrage. To account for local variation, different degrees of stringency, permitted practices, and the Fed's mandate regarding financial stability, the Fed proposes the use of scalars or similar adjustments. A supervisor specifically noted, *"There is a wide use of permitted practices, which we will have to normalize for."* Adjustments would need to account for differences in standards as well as accounting rules. Creating such adjustments could be both complicated and somewhat political. Furthermore, addressing variations between international regimes will be even more challenging. Fortunately, many of the SLHCs under Fed supervision have limited international operations, which may simplify some of the comparisons.

While many details still need to be worked out, participants cited the significant benefit of alignment between the Fed and NAIC on developing capital approaches for non-systemic insurers. Many commentators originally feared domestic standards that did not align or, in the worst case, actually conflicted. The Fed and NAIC's decision to pursue similar aggregation approaches will help to facilitate the development of both approaches, their acceptance by the states, and their ultimate implementation.

### The Fed is finalizing a consolidated approach for systemic insurers

The Fed is also responsible for systemically important institutions, which, as Governor Daniel Tarullo described, require a different approach for capital supervision.[6] As of July 2016, there are two insurance groups under this designation.

The Fed's approach, which it is calling "the consolidated approach," would assign each group's assets, liabilities, and select other exposures to risk segments; apply risk weights to the segments; define qualifying capital; and establish a ratio of qualifying to required capital.[7] The Fed anticipates broad risk segmentation initially, and increasing granularity and risk sensitivity over time. This approach would use consolidated financial information based on US Generally Accepted Accounting Principles (GAAP), with certain regulatory adjustments.

Implementing this approach, however, would not be without complications. One supervisor noted, *"This would be easy work if there was a plug-and-play group capital model to take off the shelf. We are pioneers in this area. It is a high hill to climb."* While industry participants acknowledged the Fed was still early in its thinking, many sought clarification in the following areas:

- **Use of internal models for determining required capital.** Solvency II, the European Union's revised prudential regime for insurers, allows for some national variation and for firms to determine capital levels according to individual internal models. Some commentators speculated on whether the Fed would adopt a similar approach for its group capital standard. In proposed rules, the Fed has ruled this out, stating, "Internal models make cross-firm comparisons difficult and lack transparency to supervisors and market participants."[8] Participants sought clarity on the Fed's decision to reject their use, especially after many firms have invested significant resources in boosting their own use of models. One supervisor explained, *"It is impossible to rule out models entirely, but we don't want a company-based model to dictate capital. A significant weakness of Solvency II is the requirement for internal modeling. Some modeling is unavoidable, but how much do you want to introduce it into regulation? We are loath to have the regulated tell the regulator what the capital should be."*

- **Degree of risk sensitivity and segmentation.** Defining risk segments for the consolidated approach will be a complicated process. The Fed has already proposed segmentation for the purposes of SIFI reporting, and it may use it for the consolidated approach as well. Broadly, this includes segmentation according to investment types, insurance, and other financial data.[9] Initial descriptions of the consolidated approach describe a relatively simple design, resulting in broadly defined risk segments and thus limited risk sensitivity. Some critics warn of potential unintended consequences. One executive noted, *"If it is going to be a blunt tool, it will force people to align in ways that are not risk sensitive."* Supervisors acknowledged these concerns, commenting that they will likely introduce more risk sensitivity as they gain a greater understanding of their supervised firms. In addition, supervisors hope to use the upcoming feedback process to gather stakeholder input and work to mitigate potential issues.

*"If people stop writing good product because it is no longer economical, then you need to be careful that you don't end up changing insurance as we know it."*
– Director

- **Capital definitions.** One director asked, *"What will constitute capital? What is the corresponding definition of acceptable capital instruments? How will it be defined? It is pretty fundamental to get this right."* Participants wondered if capital should be categorized into tiers and what will be deemed *"qualifying capital."* In addition, many industry representatives have expressed concern that it is extremely difficult to make capital comparisons across multi-line insurers. The Fed has specifically solicited feedback from industry on appropriate capital definitions.[10]

- **Incorporation of stress tests.** While many participants expressed optimism regarding the Fed's proposed capital regime for systemic insurers, some industry representatives cautioned that the advent of more widespread stress testing may have a greater impact on capital levels than the requirements themselves. Stress testing for insurers is still somewhat novel, but the Fed and the European Insurance and Occupational Pensions Authority, among others, have begun to test regularly. One subject matter expert warned, *"This capital regime may become the basis for stress tests, which will be the real limitation on capital, as opposed to proposed capital ratios."*

**Is the role of liquidity being overlooked in the prudential debate?**

As domestic authorities continue to debate capital approaches, there is an increasing recognition of the importance of incorporating liquidity considerations into prudential frameworks. One participant cautioned not to conflate the two: *"Capital is whether you can pay claims; liquidity is about having the assets to meet obligations at any point in time. You get into trouble when you blend them."*

- **How important is liquidity?** Policymakers note that most insurance failures involve a liquidity component, yet much of the public debate has focused purely on capital. One supervisor commented, *"Never once in the dark days were we worried about insurers paying claims. My primary concern was funding issues, liquidity, and the ensuing death spiral. That kind of action is more worrisome than paying policyholders."*

- **Recent regulatory action on liquidity.** The Fed, UK Prudential Regulation Authority, and other regimes are closely examining liquidity. The Fed recently issued proposed liquidity-risk-management requirements for SIFIs. These include a 90-day liquidity buffer to allow companies to keep operating in periods of stress,[11] regular liquidity stress testing, contingency funding plans in the event of a liquidity crunch, and comprehensive cash-flow projections.[12] Some industry experts predict liquidity will soon become part of Financial Stability Board's formal discussions, and that it will grow in importance within domestic supervisory debates as well.

*"Right now, there are no guardrails on liquidity, and we see a real opportunity to add value there."*
– Supervisor

## Despite some challenges, the international standards development process is moving forward

As the development of US capital regulations accelerates, complex US insurers also face mounting pressure to conform to global rules and capital standards. International standards development at the group level is driven by concern about financial stability and the role that the largest insurers could play in transmitting or exacerbating financial shocks. Despite new regulations, a recent International Monetary Fund report suggested that systemic risk in the insurance sector has grown since the 2008 crisis.[13] Findings such as these create greater pressure on the IAIS and national supervisors to develop global capital, transparency, and macroprudential standards to better oversee systemic risk arising from the sector.

Many participants agreed that standardized group-level capital requirements would serve an important function by boosting firm solvency, increasing financial stability, reducing regulatory arbitrage, allowing comparability across firms, and establishing a level playing field. Even with an increased sense of urgency, international discussions remain difficult because of competing philosophies and national interests, leading many critics to question their likelihood of success.

### US authorities and insurers have concerns about the development of a global standard

The IAIS, traditionally a forum for international regulators to establish best practices, has been tasked by the Financial Stability Board with creating the first global insurance capital standard (ICS). The ICS, which would apply to internationally active insurance groups, has generated heated debate within the United States. While progress on the ICS has slowed somewhat, the IAIS plans to finalize a "Version 1.0" by 2017, followed by the adoption of a 2.0 framework in 2019 with full implementation by 2020. [14]

*"Solvency II isn't perfect. That is why it needs a volatility adjustment, a matching adjustment, and 16 years to phase it all in."*
– Participant

A recently released consultation paper noted that the 1.0 draft will allow for two forms of valuation: market-adjusted valuation and Generally Accepted Accounting Principles with adjustments (GAAP Plus).[15] The 1.0 calculation also will address qualifying capital resources and the scope of the group, or the bounds of the ICS calculation. However, the initial proposal delays decisions on several issues including, the use of internal models, transitional arrangements from existing regimes to the ICS, assessment of comparability of regimes and the ICS, fungibility of capital, and enforcement.[16] As ICS development continues to move forward, participants cited the following concerns:

- **Imposition of approaches poorly aligned to US standards.** Despite assurances from US regulatory participants, some directors expressed fears that the IAIS is marching forward with a standard that does not align with the US market. US regulators are firm in their support for developing international standards; however, they differ significantly from European counterparts regarding the form requirements should take. These concerns are particularly acute in light of initial feedback on a likely ICS approach. *"I hear from participants that they don't like the market-based approach and that it is inappropriate for an industry with long-term guarantees and little liquidity concerns,"* a director said. Several IGLN participants shared concerns that Solvency II's capital levels are too burdensome and that the regime may blunt the industry's important role as a countercyclical agent in financial markets. One director added, *"European policymakers recognized Solvency II was way too punitive … The capital requirement is driving product and pricing decisions. There is a good lesson that you can overdo these requirements."*

- **Proliferation of multiple requirements.** Whether discussing US or international standards, non-executive directors remain concerned about their ability to govern single groups that must conform to multiple, and sometimes conflicting, rules. *"Capital standards that are consistent across the world are increasingly important,"* commented a director. Participants also noted the potential for greater tension between authorities as they try to work through separate approaches.

- **Scope creep.** Several participants predicted that more companies may be swept into global regulatory regimes than originally envisioned, and this could occur regardless of the risks these firms present. One participant said, *"These international capital standards are now spreading to companies that were not expecting it, especially property and casualty firms. They are getting swept in. Should they be tagged the same as life or long-term product companies? The life and annuity companies have been ready for this, but the [property and casualty] firms just weren't."*

- **Unclear hierarchy of approaches.** Participants are not clear whether global requirements could supersede or take precedence over local ones, particularly since jurisdictions including the United States are still in the process of developing new requirements. One director asked, *"I am curious how the global process will impact us. Do capital standards domestically now go out the window? Will our domestic regulators stand up when the international community comes out with their own standard?"* Within the United States, global standards may still need to be approved locally, but participants wondered to what degree international standards might influence local regulatory activity.

- **Enforcement of new standards.** Some participants noted that international standards might be more like suggestions, guidelines, or benchmarks that do not carry the weight of law. Will they then be enforceable or will they require enabling legislation? US supervisors emphasized that any international standards will not be self-executing in the United States and would require the passage of new federal or state laws and local enforcement. Changes in laws may be particularly difficult to achieve in the current divided political environment. One participant summarized, *"The IAIS can meet, but enforcement is the $64,000 question. Nobody knows the answer."*

- **Diluted standards.** Critics of the international process often contend that ICS standards will not be meaningful because a consensus among so many different groups will be either too weak or impossible to attain. *"International regulators are trying to work together, but they are not aligned. There is a lot of time being spent working on it, but nobody thinks IAIS will come out with something meaningful,"* a participant commented.

In response to these concerns, supervisors underscored their desire to achieve consistency of outcomes across multiple regulatory regimes – a result that would address many of the concerns raised by insurers. However, they cautioned against a misplaced emphasis on convergence of standards. *"I'm sure you would all love capital regimes to line up perfectly, but it is a stretch to think we will all have one regime,"* said one participant. Another added, *"If the word convergence means one system, then I'm not in favor, but convergence of outcomes is doable."* Supervisors noted that many insurance products are truly local, making a one-size-fits-all solution inappropriate. One executive agreed, saying, *"The only thing we should be concerned about is whether these different tools drive us to do good things. In that case, multiple standards are OK. The problem is if they are calibrated in such a way that this does not happen. It needs to be calibrated more towards risk sensitivities and common sense."*

While philosophical differences and outstanding concerns regarding the ICS process complicate international discussions, US authorities cautioned against viewing progress on domestic standards as the death knell for the international process. *"You can't wash away the IAIS process with US standards. It is going to happen,"* said a policymaker. Furthermore, supervisors remain supportive of the overall process. One supervisor summarized, *"We believe in the efficacy of global standards, but we also don't see that work as a panacea. Often, nationalistic prejudices creep into the process, but we don't want a race to the bottom where regimes can be arbitraged in the global arena."*

**Regulatory and industry engagement will help drive future progress**

In an effort to improve engagement and influence on global standards development, the NAIC, the Federal Insurance Office, and the Fed formed a partnership, referred to as Team USA, to represent the United States at the IAIS and to develop an alternative to the IAIS's focus on a prescriptive capital standard. Industry and other sector stakeholders are optimistic that this partnership among US authorities will be effective. One supervisor noted, *"The cooperation between our groups has never been better. When we face the international community, we face it in a unified fashion. When we look at how we are engaged with the international dialogue, it has never been stronger."*

*"There is a lot of importance in making sure US interests are aligned so that the US can effectively operate."*
– Supervisor

In addition to supervisory cooperation and engagement, most participants acknowledged that industry engagement will be essential to the development of effective global standards. *"We all owe it to the common good to work toward a productive outcome,"* said a participant. Supervisors encouraged insurers to support the international process by engaging in IAIS stakeholder dialogues and data collection processes. As the IAIS fine-tunes its approach, it is relying heavily on voluntary participation from firms to share data in order to make appropriate tweaks in its formulas. A supervisor noted, *"Engagement with firms is very important. It is important for IAIS to hear directly from you when you see bias or problems, whether it is through field-testing or other methods. The feedback is taken very seriously by the IAIS."* He added, *"US companies have to be involved in the data calls. If we are going to climb that hill, we need your help or we lose credibility at the table."*

**Additional IAIS work streams: systemic activities and global systemically important insurers (G-SII) designation**

The IAIS is undertaking a number of reforms in addition to developing the ICS. Participants highlighted the following activities as most relevant in the coming year:

- **Systemic activities classification.** On June 16, the IAIS announced a series of changes in its process for identifying insurance product features that create systemic risk. Importantly, the IAIS dropped its historical non-traditional, non-insurance (NTNI) label.[17] Instead, it said it would take a more "granular" and "nuanced" approach, focusing on indicators of macroeconomic exposure and substantial liquidity risk.[18] The June policy paper highlights a number of product features that expose firms to systemic risk, such as guarantees and credit protection.[19] The IAIS also recognized that insurers can engage in activities that amount to "shadow banking" and therefore fall into the category of non-insurance; examples include capital market activities that result in maturity transformation, leverage, or imperfect transfer of credit risk.[20]

  IGLN participants remain mixed on the degree to which their products are truly systemic. One director said, *"I do think we have to try and identify systemic activities. We have to guard against our own companies creating products that may not be fundamentally systemic, but in a certain scenario become systemic."* However, several participants also argued that ultimately public policy (e.g., monetary policy, promotion of specific investments, or lending), more than specific products, form the foundation of systemic risk. This is because of the magnitude, duration, and relatively lower response to market signals that many public policies entail. One executive noted, *"The regulation of markets is inherently political, but markets are systemic, not individual products. Things like China or interest rates are the real systemic problems."*

- **G-SII designations.** On June 16, the IAIS also announced an overhaul to the process for designating G-SIIs. The new methodology is intended to improve transparency, making it easier for firms to reduce activities that contribute to higher risk weightings. The process will now include a qualitative phase, and firms absolute positions rather than their positions relative to their peers will be given more careful consideration.[21] Thus far, the Financial Stability Board – responsible for the designation of firms – has not officially endorsed the revised process, which has caused some insurers to speculate about whether it will be used in the fall of 2016, when the IAIS and the Financial Stability Board will announce a revised list of G-SIIs.[22]

## Unprecedented external dynamics are forcing industry and supervisors to adapt

While solvency and capital discussions seem to dominate much of the industry-regulatory dialogue, IGLN participants noted the importance of looking beyond capital. One director commented, *"High capital is one way to protect consumers, but the better way is appropriate business models."* The insurance sector faces one of its most difficult periods in recent memory. Economic, regulatory, technological, and structural challenges are driving insurers and supervisors to redesign many aspects of their traditional models.

### The global insurance outlook is extremely daunting

*"We are in a VUCA [volatility, uncertainty, complexity, and ambiguity] world. I've never been in a day and age where we truly know nothing. There are so many uncertainties in the macroeconomic and geopolitical space. I don't know what to do, other than be prudent,"* said a director. Participants widely agreed that it is a fragile time. Leading insurers and regulators described the following headwinds as most consequential to their businesses:

- **Geopolitical instability exemplified by the UK's vote to leave the EU.** Per IGLN participants, the scale and scope of significant geopolitical events is rising. Rapid societal changes, decelerating economies, economic dislocation, and high debt levels are contributing to political instability and rising populism around the globe. The UK vote to leave the European Union (Brexit) is the most recent and severe example of what some fear is a trend that could result in the dissolution of cooperative multinational organizations, greater isolationism, and the creation of power vacuums as formerly dominant nations recede from the international arena. As Brexit demonstrated, this, in turn, can further exacerbate political and economic instability, leaving directors to agree with one who simply remarked, *"What the hell do we do now?"*

- **An unparalleled macroeconomic environment.** One participant said, *"Money is free and there are no returns in the long term. It is a set of conditions I have never seen in my lifetime."* IGLN participants have debated the impact of low interest rates for years, yet new market and monetary policy developments, including the advent of pervasive negative interest rates at longer durations, pose significant challenges for leading insurers. Brexit has all but ensured that rates will continue to stay low for the foreseeable future and may fall even farther, further dimming the prospects for insurers. In addition, participants continue to worry that divergent economic policies and timing could disrupt capital markets. As the United States begins to raise rates to more normal levels, the European Central Bank, Japan, and China are likely moving into renewed periods of monetary stimulus. As well, there is concern that when the next economic downturn occurs, many countries will not have adequate remaining fiscal or monetary policy tools to deploy, having largely exhausted most of their capacity fighting the last crisis.

- **An array of structural changes driven by technological disruption.** One director remarked, *"We are all struggling with digital disruption. Now it is a 'burning platform' – time is running out. If you are a global company, it is not an easy situation."* Regulation may have slowed the march of disruptive new entrants into the insurance industry, but it has not protected the full value chain. One observer writes, "In the short term, the technology threat may come from a growing band of startups that nibble away at specific parts of the industry;" these include peer-to-peer insurers, robo-advisers, digital distributors, and telematics specialists.[23] However, over the long term, the threat is even greater as new competitors may prove more agile and effective at deploying the newest data and other technologies, making entrenched business models obsolete.[24] One participant warned, *"None of this will stop anytime soon."*

*"We are in the most challenging era. If we are looking at the shorter end, then our lives are manageable, but long-duration assets and liabilities are very difficult."*
– Director

**Institutions are responding in very different ways**

According to participants, complex insurers have few good options. Regulation and growing uncertainty both demand the maintenance of high levels of capital. In such a challenging environment, there is then far less available capital for the kind of investment that may be required to compete effectively in the digital age. Complex insurers are taking fairly different approaches to the current conditions. Some participants suggested it is possible to manage through these difficult times, while others said that more transformative change is coming. One optimistic executive argued, *"As long as we price appropriately, I feel pretty good about where we are."* In contrast, one director remarked, *"The stress is becoming unbearable on basic business models. Now companies have to have underwriting performance and there are consequences to that."* Already, some major insurers are radically revamping their business models by offloading certain business lines and refocusing on core activities. A director summarized, *"When something structurally changes, it ripples through the entire business value chain and everybody adjusts."*

**Regulators are also reviewing their approaches**

As industry debates how to adjust to the new normal, supervisors are considering these issues as well. While much regulation is retrospective, supervisors are keen to become more forward looking. Supervisors highlighted three areas in which they are working to better position themselves for the future:

- **Macroprudential supervision.** Supervisors shared concerns regarding rising market volatility and greater systemic risks. They noted increased efforts to monitor these developments via more data collection and cross-sector analysis. For instance, the Fed is now using more horizontal reviews to analyze activities and risks across portfolios, along with promoting the evaluation of systemic risks by studying how macroeconomic risks could affect individual firms and the wider sector.[25]
- **New uses of data.** One executive noted, *"As we get more and better data, what are the implications for the traditional insurance business model? How are regulators approaching this issue? There is asymmetric information, negative selection, and all kinds of issues."* To date, innovative underwriting and the use of analytics has for the most part benefited consumers. Yet some participants cautioned that innovation could work against certain individuals in the future, resulting in higher prices or an inability to obtain insurance. One supervisor warned, *"In order to make underwriting performance, we can see the temptation to use non-risk factors. There is a big regulatory dilemma on whether to allow it."* An executive added, *"A lot of people think it is unfair to discriminate based on what we know about you. If you say it is politically unacceptable, it is a very different world."* As of now, supervisors acknowledged there are real ethical issues to consider in the use of data, and they are monitoring developments closely.
- **Regulatory agility.** Regulators and supervisors are now developing approaches to oversee new innovations. One director noted, *"It is important to make sure regulators facilitate and endorse innovation in digital models rather than restraining it."* Participants universally advocated for regulatory structures that encourage innovation among both new players and incumbents. The UK Financial Conduct Authority's sandbox initiative provides one possible regulatory model to address innovation.[26] One director summarized, *"We need a flexible regulatory policy that doesn't always come down hard when you cross the line and allows you to learn something that is useful for both parties."*

*"I've seen our supervision up the ante on how we look across firms with more cross-sectoral analysis. There is more going on at the peer-to-peer level than ever before."*
*– Supervisor*

*"Regarding the risk profiling of an individual, how and if it gets used when it is not in the consumer's favor is tricky."*
*– Supervisor*

*"How do regulators here and abroad plan to support innovation without squeezing the life out of it?"*
– Participant

★★★

Since the financial crisis, the US insurance regulatory landscape has been in a state of flux. US authorities are working toward more effective and efficient capital regulation that will bring an end to much of that uncertainty. While supervisors move toward greater regulatory certainty on capital, an array of forces (political, social, technological, and economic) is contributing to far greater market uncertainty. Several directors agreed with one who said, *"When the whole structure shifts, what you used to know doesn't apply. You need a new way of operating."* Whether large insurers simply adjust existing models or make more radical changes, it is clear that the path for these organizations and their boards will remain challenging for years to come.

## About the Insurance Governance Leadership Network (IGLN)

The IGLN addresses key issues facing complex global insurers. Its primary focus is the non-executive director, but it also engages members of senior management, policymakers, supervisors, and other key stakeholders committed to outstanding governance and supervision in support of building strong, enduring, and trustworthy insurance institutions. The IGLN is organized and led by Tapestry Networks, with the support of EY. *ViewPoints* is produced by Tapestry Networks and aims to capture the essence of the IGLN discussion and associated research. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, senior management, advisers, and stakeholders who become engaged in this leading-edge dialogue, the more value will be created for all.

## About Tapestry Networks

Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. To do this, Tapestry forms multistakeholder collaborations that embrace the public and private sector, as well as civil society. The participants in these initiatives are leaders drawn from key stakeholder organizations who realize the status quo is neither desirable nor sustainable and are seeking a goal that transcends their own interests and benefits everyone. Tapestry has used this approach to address critical and complex challenges in corporate governance, financial services, and healthcare.

## About EY

EY is a global leader in assurance, tax, transaction, and advisory services to the insurance industry. The insights and quality services it delivers help build trust and confidence in the capital markets and in economies the world over. EY develops outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, EY plays a critical role in building a better working world for its people, for its clients and for its communities. EY supports the IGLN as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

## Appendix 1: Meeting participants

**Aegon N.V.**

- Robert Dineen, Audit Committee and Risk Committee Member

**AIG**

- John Fitzpatrick, Risk and Capital Committee Chair, Audit Committee Member
- Doug Steenland, Chair of the Board
- Terry Stone, Regulatory and Public Policy Committee Chair, Audit Committee Member

**Aon**

- J. Michael Losh, Audit Committee Chair

**Aviva**

- Bob Stein, Nominating Committee, Remuneration Committee, and Risk Committee Member

**Chubb**

- Theodore Shasta, Audit Committee Member

**Federal Insurance Office**

- Steven Seitz, Deputy Director, Financial Stability

**Board of Governors of the Federal Reserve System**

- Thomas Sullivan, Senior Adviser

**Illinois Department of Insurance**

- Anne Melissa Dowling, Acting Director; NAIC Vice Chair of Property Casualty Committee

**Missouri Department of Insurance, Financial Institutions and Professional Regulation**

- John Huff, Director; NAIC President

**Prudential Financial**

- Nicholas Silitch, Chief Risk Officer and Senior Vice President

**Sompo Japan Nipponkoa**

- Jan Carendi, Senior Advisor to CEO

**Standard Life**

- Noël Harwerth, Audit, Risk, and Nomination and Governance Committee Member

**USAA**

- Herman Bulls, Risk Committee Chair

**XL Catlin**

- Kirstin Gould, Executive Vice President, General Counsel, and Corporate Secretary

**EY**

- Rick Marx, Principal, Business Advisory Services
- John Vale, Principal, Insurance Advisory Services
- Tom Ward, National Director, Insurance Regulatory Group

**Tapestry Networks**

- Leah Daly, Principal
- Colin Erhardt, Associate
- Peter Fisher, Partne

## Endnotes

[1] ViewPoints reflects the network's use of a modified version of the Chatham House Rule whereby names of network participants and their corporate or institutional affiliations are a matter of public record, but comments are not attributed to individuals, corporations, or institutions. Network participants' comments appear in italics.

[2] Daniel K. Tarullo, "Insurance Companies and the Role of the Federal Reserve" (speech, National Association of Insurance Commissioner's International Insurance Forum, Washington, DC, May 20, 2016).

[3] Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 Fed. Reg. 114 (June 14, 2016).

[4] Enhanced Prudential Standards for Systemically Important Insurance Companies, 81 Fed. Reg. 114 (June 14, 2016).

[5] "No Model Law on the Cards for US Group Capital Calculation," *Insurance ERM*, April 7, 2016.

[6] Daniel K. Tarullo, "Insurance Companies and the Role of the Federal Reserve."

[7] Ibid.

[8] Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities, 81 Fed. Reg. 114 (June 14, 2016).

[9] The Fed further describes segments as follows: "Investment types" could include securities, charge-offs, recoveries, loan and lease losses, derivatives, and off balance-sheet items. "Insurance" would include loss, expense, and combined ratios, reserves, variable annuities, and closed books. "Other financial data" could include things like deferred taxes and variable interest entities. For more details, see Proposed Agency Information Collection Activities; Comment Request, 81 Fed. Reg. 79 (April 25, 2016).

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