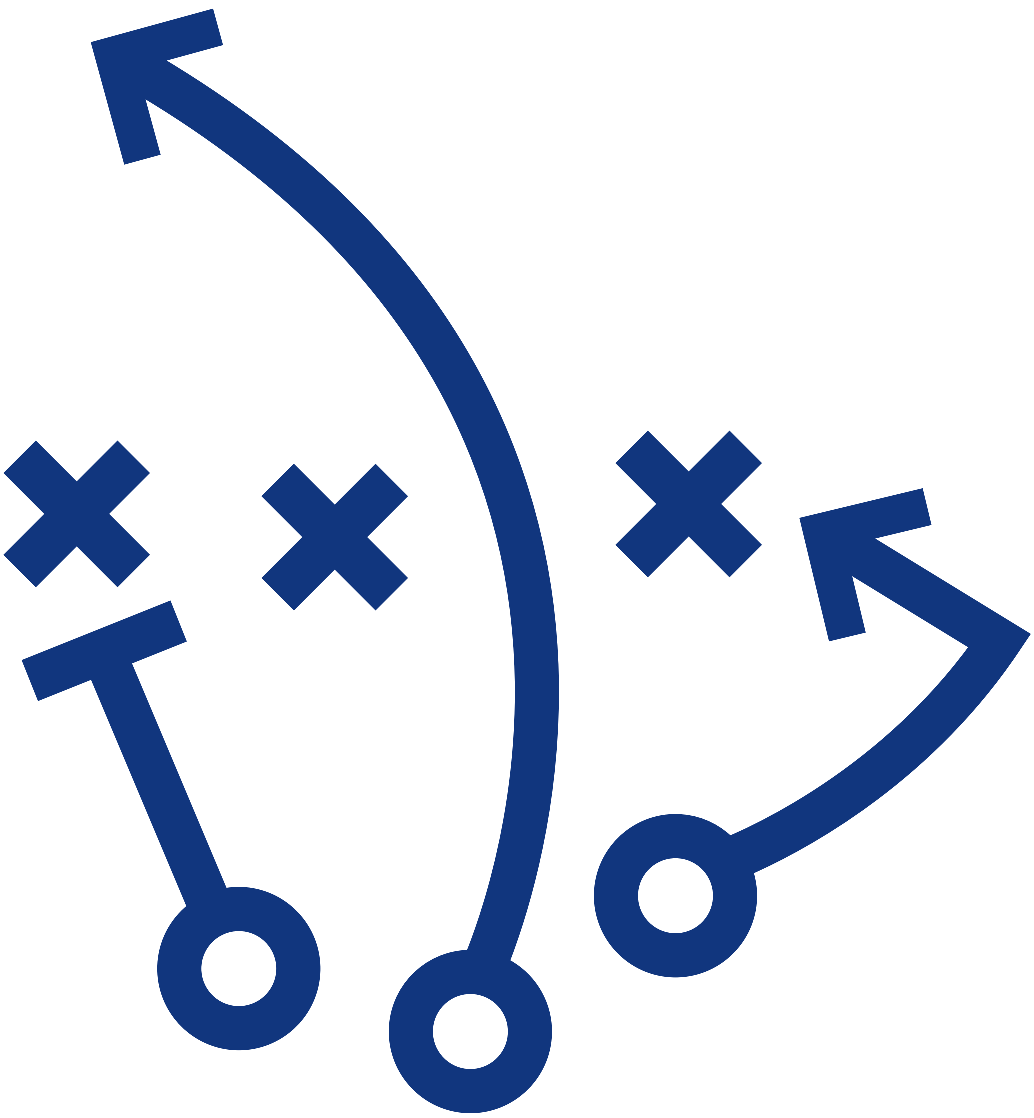
Rethinking the response
A strategic approach to regulatory uncertainty in European insurance



A Deloitte Insight report

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Note: The views represented in this paper are of Deloitte LLP only. As used in this document "Deloitte" means Deloitte LLP, the UK member firm of DTTL.

Foreword

This study brings a new perspective to regulatory change and compliance in European insurance companies. In interviews with senior insurance leaders two themes emerged on regulation:

- First, the volume of new insurance regulation and the pervasiveness of supervision have materially increased since the financial crisis to a level not seen in decades, and insurers are running to keep up.

- Second, although it is increasingly important to the direction of insurance companies, at this juncture insurers are finding it tough to form strategic plans involving regulation, due to its shifting nature.

Coping with this combination of high volume and uncertainty is an increasingly important management challenge for financial services organisations. In fact, certain European insurers have recently announced they are seeking to re-domicile headquarters to more stable regulatory environments to reduce their exposure to such uncertainty.

Although Solvency II (SII) timelines have moved, few insurers feel 'regulatory change' has run its course. Financial services organisations are developing a range of responses to the new regulatory agenda. Some have elevated the importance of regulation as a 'risk class', shoring up CRO and other 'C-suite' responsibilities to mitigate it, while others have sought to develop new change and compliance roles with greater strategic responsibilities. From interviews it is clear that some EMEA insurers are seeking to respond proactively to the new regulatory landscape, and there are pockets of best practice.

At the same time, other insurers are behind the curve. They have internal obstacles curtailing their ability to respond effectively to the new regulatory agenda. Senior leaders may fail to acknowledge the full scale of the impact of new regulation and supervision on daily business decisions and some have not yet worked out how best to accommodate regulatory change into strategic decision-making. In addition insurers are struggling to take a more planned approach to regulatory implementation.

In the face of regulatory uncertainty many insurers feel they must adopt a 'wait and see' stance on key issues – which can result in a form of strategic paralysis. Supervisors are looking into how they can alleviate this. But at the same time there are tools and techniques that insurers could adopt too. This study poses two questions: what role does regulation play in strategic decision-making, and how should insurers implement the regulatory agenda more efficiently and effectively? In answering these, this study presents a new approach for rethinking the response to regulation.

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Global IFRS Insurance Lead Partner

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Executive summary: A new approach

Here to stay

The regulatory landscape for European insurers has shifted dramatically since the financial crisis began in 2007. This shift has been great enough to make insurance regulation an important long term, 'structural' driver. The rise in importance of regulation is clear: Deloitte estimates the European insurance industry spent €4.2-€4.9 billion in 2012 complying with all new regulations (with expected implementation dates 2012-15) and similar amounts in the previous two years. For each top 40 European insurer, the costs of complying with new regulations were in the range of €214 – €217 million for 2010-12 inclusive. These costs alone show that regulation is strategically important. They are equivalent to a 1.01 percentage point impact on return on equity (ROE), and they are costs for which a return should be sought (see 'About this research').

This elevated level of regulation is here to stay. Deloitte interviewed senior insurance leaders in Europe representing one third of the top 40 European insurance firms. Most expect the cost of complying with new regulation to continue at current elevated levels until 2015, spread across several key regulations including IFRS 4, Solvency II (SII), IFRS 9, SIFI rules, FATCA and insurer stress tests among others. And many expect the new regulatory agenda to stretch far beyond this timeframe.

'Knowns' and 'known unknowns': a new approach needed?

The new regulatory agenda presents many more challenges than the simple headline cost. It is leaving insurers stretched, uncertain and requiring new capabilities. From interviews, Deloitte sees two key challenges:

- ***Volume:*** A regulatory 'multiplier effect' is occurring, where regulation is impacting more insurance processes across more jurisdictions. Higher regulatory volume in multiple jurisdictions is leading to 'execution-stretch' and sub-optimal implementation of regulatory changes.

- ***Uncertainty:*** The shifting new regulatory agenda is leading to significant uncertainty. Regulatory 'known unknowns' are creating planning difficulties for insurers, and can lead to strategic paralysis.

In addition new capabilities are required to plan for, and absorb, the new agenda. Regulatory change and compliance teams are required to identify overlaps and efficiencies across regulatory programmes; monitor and interpret shifting regulatory requirements; manage how potential changes impact the business and its strategic plans; and respond rapidly when regulation is finalised and a course of action decided. Gaining a thorough understanding of the dimensions of each new regulation by level of certainty is a new necessity for insurers. In the light of this Deloitte believes that a new approach to dealing with regulatory change and compliance is required.

Obstacles to a new approach

There are obstacles to adopting a new approach within insurance companies. Few compliance and regulatory change teams have been built to deliver the new requirements, or indeed cope with the high volume of new regulation and pace of change. With the exception of some leading edge insurers, many teams responsible for regulatory change and compliance within insurance companies operate in silos, unable to effectively integrate or coordinate their change initiatives.

Through interviews, Deloitte observed two main obstacles to higher performance in regulatory change and compliance teams. First, few insurers have a single view of regulatory change against which they can effectively plan – and this risks 'digging up the road again and again' where implementation programmes are not coordinated. Second, regulatory competencies and insights are poorly represented in strategic decision-making and struggle to support senior leaders as they make strategic decisions. This is due to a lack of enterprise-wide regulatory information and under-developed skills in dealing with 'C-suite' stakeholders.

Not all regulatory change and compliance teams suffer from such obstacles. Examples of good practice were found across the industry, where a more planned and coordinated approach to implementation and input into strategic decision-making processes can be observed. Some insurers are starting to coordinate across their regulatory change and compliance teams in order to improve the management of their firm-wide response to regulation.

Rethinking the insurer response

To cope with regulatory change, some insurers are starting to employ a number of disciplines. Deloitte suggests bringing together these disciplines into a single approach to regulation which has at its core the issue of regulatory uncertainty:

1. **Coordination and governance.** Establish a Regulatory Assessment and Response Executive (RARE) with a remit to achieve better coordination across the core regulatory change activities.

2. **Aggregated (single) view.** Create a single view of regulation across all regulatory change and compliance functions, through aggregated regulatory risk data and improved monitoring and interpretation of regulations impacting the firm.

3. **Regulatory portfolio management.** For the most foreseeable regulations, using a portfolio management approach can create a more coordinated response to implementation, taking into account themes across multiple regulations, other change initiatives and the firm's strategic objectives.

4. **Scenario planning.** For regulation which carries some 'unknowns', scenario planning techniques should be used to identify likely outcomes and bring regulation, and those functions dealing with it, more fully into strategic decision-making processes.

5. **Absorb uncertainty.** Where regulatory planning becomes too difficult due to the uncertainty of future regulatory and political developments, insurers can take several pre-emptive actions. These may include creating more flexible, rapid-response regulatory change and compliance teams for when regulatory factors do become apparent, or adjusting operating models to reduce regulatory exposures where possible.

6. **Embed a new modus operandi.** For future regulatory decisions a new framework should be put in place to embed the whole regulatory decision-making process. This framework will enable insurers to translate regulatory analysis into actionable plans.

Some insurers are working on individual elements of this approach. Front runners are finding ways to improve collaboration and integration across regulatory and compliance-related teams. Others are improving regulatory intelligence (data). In determining how to proceed and what to prioritise, working out the overall regulatory approach is essential. Deloitte's suggested approach to regulatory uncertainty is illustrated in Figure 9.

Few insurers wish to be a 'first mover' in building new regulatory solutions when the regulatory environment is so uncertain. Many are likely to adopt a 'wait and see' approach and seek to minimise costs in the meantime. However, adopting a new approach to regulatory change may turn out to be a way of reaping business benefits from the considerable incurred costs associated with regulatory change.

Regulation is here to stay

Regulation has become a 'structural' trend requiring greater strategic consideration

Since the financial crisis, the pace of regulatory change in the European insurance industry has accelerated dramatically. The majority of senior insurance leaders interviewed for this paper agree – the changes represent a once-in-a-lifetime shift in their regulatory landscape. It is also clear that insurers do not expect this period of intensive regulatory activity to subside any time soon.

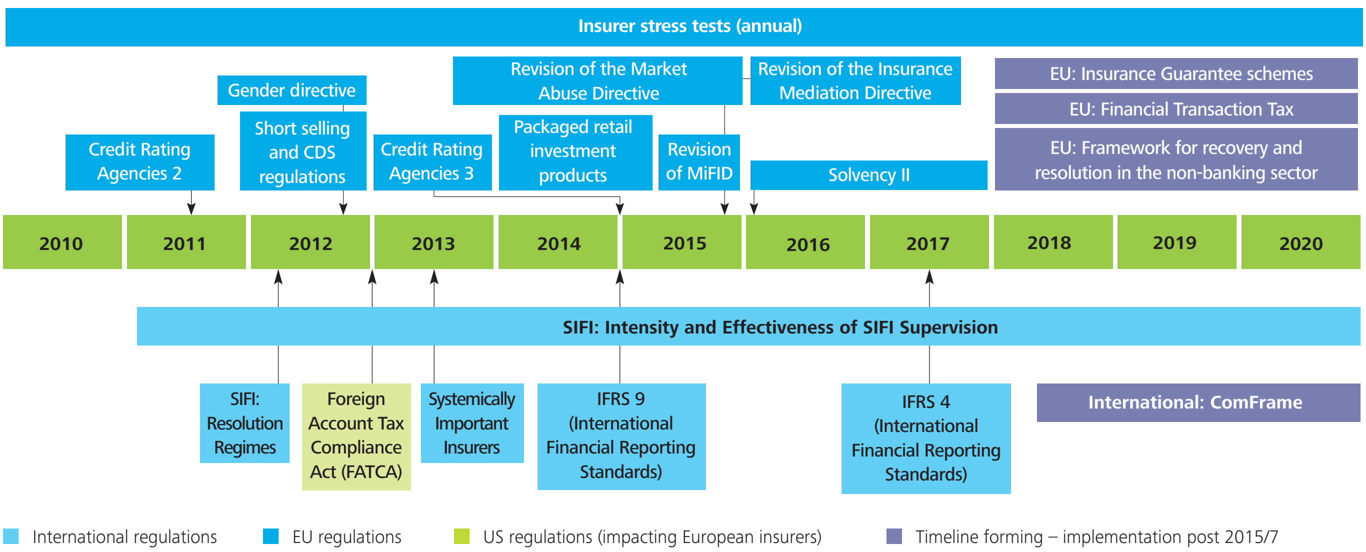
Management theorist Peter Drucker wrote that in times of change and uncertainty, forecasting and planning are a challenge. In such times, he suggested, organisations should formulate their strategies by focusing on the key 'structural' trends impacting them.[1] He defined such trends as: 1) 'currently underway', 2) 'strategically significant' and 3) 'not yet fully played out'.

Applying Drucker's criteria, Deloitte's view is that regulation can now be regarded a 'structural' driver of the insurance industry, and this has implications for the way regulation should be managed in insurance companies.

Regulation is most definitely 'underway'
The soaring volume and cost of new insurance regulation over recent years show that the industry is undergoing a significant structural shift.

At the European and national level, supervisory bodies in financial services, accounting and social policy have all introduced significant new regulation. Deloitte estimates insurers in the United Kingdom, Germany and France will be subject to 29, 32 and 35 new regulatory reforms respectively in 2012-17. Figure 1 illustrates our view of the implementation timeline for 20 European Union (EU) and international regulatory changes.[2] Adding to this, there are numerous regulations to which large global insurers will be subject in local jurisdictions and markets, many of which are increasing their regulatory requirements. Much of this is over and above 'business as usual' (BAU) regimes already in force.

Figure 1. Illustrative timeline of new European and international regulations impacting EU member insurers 2010-20 (EU)



Note: Dates are for expected implementation. Not all dates are certain. Where the timetable is being formed, regulation has been assigned to post-2017, which is likely but not certain. Not all EU members are subject to the Financial Transaction Tax.

Source: Deloitte Insight, 2013

In Figure 1 it can be seen that significant new regulation is emanating from EU and international bodies. However, national agendas are also having a significant impact. Respondents to our survey in the three largest EU economies (Germany, France and the UK) were asked to rank the top five regulations affecting them in 2012. National regulations (in headquarter jurisdictions) represent one-third (36 per cent) of all regulation deemed to have a particularly large impact – the rest coming from European or international bodies.[3]

The cost of complying with the new regulatory agenda (implementing and maintaining) shows the significance of the regulatory burden. For the European insurance industry, Deloitte estimates the total cost of complying with all new regulation (expected to be implemented in 2012-15) was in the range of €4.2 – €4.9 billion in 2012 alone.

"On total compliance costs, there is nobody in the organisation who could answer this. No one knows the answer to this question."

Global strategy director, large global life insurer

Figure 2. Cost of new regulation (implementation and maintenace) to the European industry 2012

€bn, 2012	Interview sample (actual)	Sample of 40 (estimated)	European industry (estimated)
Solvency II costs	0.55	1.54 – 1.80	2.45 – 2.87
Total regulatory costs (new regulation)	**0.94**	**2.86 -3.08**	**4.21 – 4.90**
Total IFRS shareholders equity (average over 2012)	97	403	N/A
Total regulatory costs/shareholders' equity	0.97%	0.71%	
Gross written premium	213	678	N/A
Total regulatory costs/gross written premium	0.44%	0.42%	
Net earned premium	191	627	N/A
Total regulatory costs/net earned premium	0.49%	0.46%	
Operating costs	291	854	N/A
Total regulatory costs/operating costs	0.32%	0.33%	
Profit before tax return on equity	13.88%	14.89%	N/A
Return on equity impact of total regulatory costs (percentage points)	-1.17	-1.01	

Source: Deloitte Insight, 2013

Notes:
The aggregate view of the cost of new regulation was built 'from the ground-up' by asking senior leaders (interviewees) to estimate their implementation spend for Solvency II. This totalled €0.55 billion in 2012 for 13 companies. In aggregate, respondents estimated their Solvency II costs represented 58 per cent of their total cost of achieving compliance with all new major regulations listed.
The industry-wide estimate of the cost of new regulation is extrapolated from this sample of interviewees. The cost of new regulation for the top 40 European companies was in the range of €2.6-€3.1 billion in 2012 – averaging €70-€73 million per individual organisation.[4] Based on our model, this results in a total cost for the whole European industry in the range of €4.2-€4.9 billion. See 'About this research' for more detail.

The above costs do not include the BAU and implementation costs associated with running currently in-force regulatory requirements. They only relate to new regulatory requirements. Operating costs can be greater than GWP. It does not imply an overall loss because GWP excludes investment income.

"It is not the case that after Solvency II we will be exposed to less regulation. We are in a new equilibrium in terms of regulation. Anyone who thinks [the] regulatory burden will reduce in these timeframes is naïve."

CFO, international German insurer

The year 2012 was not unique, according to respondents. Average costs in 2010 and 2011 were similar, suggesting the industry has suffered elevated costs of regulatory change for the past three years.[5] The three-year cost of regulation for 2010-12 (inclusive) is estimated to be in the range of €8.1-€9.2 billion for Europe's top 40 insurers. On average for a top 40 European insurer, this amounts to costs in the range of €214 – €217million for the period 2010-12 inclusive. For the largest insurers in the sample, the figure is much higher.

A proportion of these 'regulatory' costs may include elements of projects that are required by the business for other purposes. However these measures are still important indications of the level of incurred costs where insurers are now looking to find a regulatory dividend. Deloitte considers a regulatory dividend can and should be sought.

Almost all participants in the study claimed their firms find it difficult to measure the overall cost of their often disparate and unconnected regulatory change and compliance programmes. While the costs of the Solvency II change initiatives are well understood, other programmes often are not. This suggests that our projections may underestimate the overall industry cost of new regulation, and also acknowledges an inherent, but unavoidable, modelling risk in measuring such costs. Insurers still have some way to go to improve such measurement, but attempts to address this are likely to prove valuable.

Regulation has become materially more significant

The 2012 cost of new regulation is so large it can make a direct impact on an insurer's return on equity (ROE). The estimated cost of complying with new regulation in 2012 is equivalent to a 1.01 percentage point decline in Return on Equity (ROE).

However, on this analysis, the real business impact of the new regulatory agenda is likely to be underestimated. A more inclusive analysis of the strategic implications of new regulation should include:

- A wider definition of **regulatory costs** including the cost of compliance with the current regulatory regimes, and the potential opportunity costs of redirected senior management time and diverted investment from revenue generating activities.[6]

- Assessment of the **capital implications** of regulatory change. Many senior insurance leaders are conscious of additional capital requirements resulting from poorly-managed regulatory change and compliance programmes, and acutely aware of how supervisor judgements (such as capital add-ons for G-SIFIs or in areas of doubt) could have a large impact. In progressive firms, business planners have sought input from regulatory and compliance-related functions on capital allocation decisions, where risk management and appetite also influence decision-making.

- Assessment of the **cost/benefit of improved data and transparency** for stakeholders including supervisors, shareholders, internal stakeholders and consumers.[7] Many insurers' risk management processes have improved under the new regulatory agenda, and this may filter into a lower cost of capital for those who have sufficient levels of transparency to demonstrate this. Many interviewees suggest the industry is now on a stronger footing, with a better grasp of risk management and much-improved data reporting, both contributing to financial soundness.[8]

- Assessment of the cost of **strategic paralysis**. Crucially, where regulatory change is a factor in decision-making, business planners may adopt a 'wait and see' approach. But the 'cost of doing nothing' while waiting for regulatory clarity may be significant.

- An analysis of how insurers' key **objectives** are affected by the new regulatory agenda. Respondents were asked about their strategic objectives for the period 2012-2015 and the role regulation plays in meeting them. Most interviewees stated that **financial soundness** is the key priority and believe the Solvency II exercise was beneficial to this goal, by helping to tighten risk management and risk appetite and providing impetus for more disciplined underwriting. **Improving profitability** is the second highest priority among insurers. Regulation helps in lending weight to pricing and margin discipline initiatives, but increases operational costs, so has a negative or positive impact depending on each insurer's focus. **Global growth** is the third most frequently stated aim and is a key priority for larger and more financially stable firms. The majority of senior insurers thought regulation is holding back some firms in achieving this. As the number of insurers prioritising global growth rises, the role of regulation as a strategic challenge is likely to increase.

Regulation is here to stay: it has 'not yet fully played out'

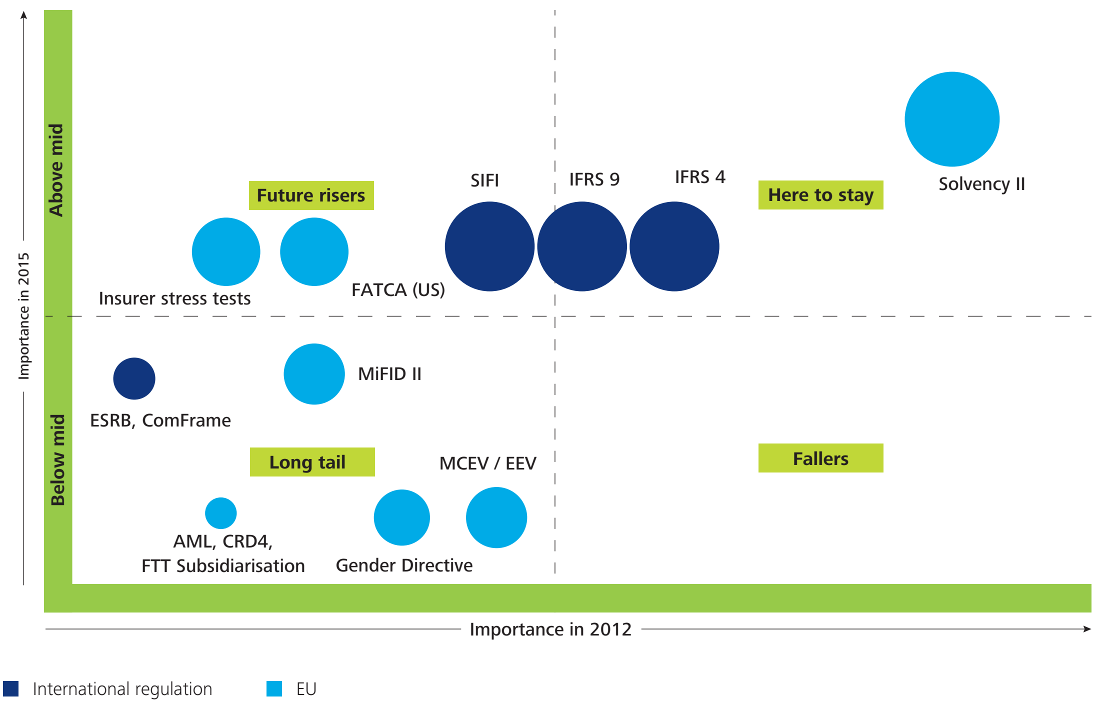
Despite new uncertainties over Solvency II implementation timelines, our research suggests senior insurance leaders are under no illusions: regulation has by no means run its course. Although most interviews were conducted when there was a hard deadline for Solvency II delivery, almost all suggest that such regulatory costs (implementation and maintenance of new regulation and supervision) are likely to continue at, or near, 2012 levels into 2015.

Senior insurance leaders were asked to choose five new regulations with the biggest impact on their organisation from 2012 to 2015.[9] While Solvency II was the main focus in 2012, by 2015 the burden is expected to be spread more evenly across a number of regulations, including IFRS 4, IFRS 9, SIFI-related change, FATCA and insurer stress tests. In short, insurers will probably have more new regulation to juggle – not less.

"Many insurance CEOs don't understand that we might not be released from the shackles until 2025."

Executive Director, international insurance organisation

Figure 3. Most important international and regional regulations 2012-15



Source: Deloitte Insight, 2013

Notes:
For regulation abbreviations see 'About this Research'. Interviews were carried out before the recent announcement that Solvency II implementation would be delayed. In the UK, almost all interviewees expressed significant concern over the shift to a twin peaks supervisory structure (PRA and FCA) and although this came into force in April 2013, most UK-based insurers in the sample expected this to have the most significant impact on the compliance burden by 2015.

"The pace of execution required to keep up is unrealistic. The regulator does not appreciate the speed of change is too fast operationally – too demanding. And when things are required to go too fast it forms a drag on the business."

CRO, Dutch insurer

Beyond 2015, no interviewees believed regulators will have finished with the issue of financial soundness, and half expected regulation relating to customers and distribution to rise significantly. Many insurers expected supervisors to intensify their activity on aspects of conduct risk (see separate text box on conduct risk).

Insurance regulation, when seen in its widest context, has become a structural trend. Insurers should take a broad view of regulatory change in its widest sense and ensure it is fully considered in business plans and strategies.

Conduct risk – MIFiD II, IMD II and PRIPs

EIOPA is set to significantly enhance conduct regulation over the coming years. The biggest change to conduct risk will likely be brought about by the revision of the Insurance Mediation Directive, which reassesses the way insurance will be sold in Europe (known as IMD II). With an aim to create more appropriate customer outcomes, IMD II is likely to significantly enhance conduct of business (CoB) requirements around the insurance sales process and extend the scope of regulation to include advisors who distribute products on behalf of insurers. Aligned to the intention of IMD II, EIOPA is also likely to promote transparency, simplicity and fairness via another regulation, Packaged Retail Investment Products (PRIPs). This is intended to develop more standardised and comparable information about the risks and costs of products, relevant regulatory requirements and complaint handling procedures. In addition, MIFiD II is also due for implementation, giving greater guidance on retail sales processes.

Taken together, this combination of regulations is likely to make both direct and intermediated distribution more onerous. Deloitte suggests the top three focus areas (themes) for conduct regulation in Europe will be based on:

1) a sales process review where insurers must demonstrate a more customer-centric approach;
2) improved product governance examining how the life-cycle of products (i.e. design, distribution and maintenance) fits with customer requirements; and
3) management of conduct risk appetite through an effective framework.

Knowns and known unknowns

New regulation leaves insurers stretched, uncertain and requiring new capabilities

The way that regulatory trends are 'playing out' is challenging European insurers and is a cause for concern among insurance leaders. Despite significant investment in regulatory change programmes, insurers are struggling with high volumes of new regulation/supervision and low levels of certainty. Insurers require new capabilities to cope.

Higher volumes of regulation have led to 'execution-stretch'
Insurers are experiencing a higher volume of regulation in two ways.

First, regulation runs deeper into insurance processes. When speaking about their domestic supervisors, interviewees unanimously agreed that regulators and supervisors have become more deeply involved in insurance processes, increasing the regulatory burden. Examples of closer supervision range from influencing risk appetite and capital allocation to requiring better documentation of decision-making and improved financial reporting.

Second, multinational insurers are witnessing increased supervisory requirements from non-domestic jurisdictions.[10] Deloitte calls this the 'multiplier effect'. Interviewees report higher barriers to entry, heavier administrative burdens and increased, more localised, capital requirements.[11] For some, a perceived increase in protectionism is impacting growth and diversification initiatives.

Adding to this, some governments are applying regulation on an extra-territorial basis, such as the US-based FATCA regime, as supervisors devise regulations with global reach. Where regulation is designed at the supra-national level, i.e. in the EU, and is in principle harmonised, national interpretations can vary widely at the point of implementation.[12]

Despite significant spending on regulatory programmes, insurers admitted they are struggling to comply with the volume of new rules. Interviewees reported that regulatory change and compliance-related teams are often overwhelmed with implementation work and that senior management time is extensively drawn into regulatory change and compliance management. While many interviewees took a pragmatic view of regulation, the pace of implementation was often considered to be a challenge. Deloitte calls this implementation challenge 'execution stretch'.

Compliance teams, historically the owners of regulatory change, are accustomed to implementing regulations on a 'one at a time' basis, often prioritising workloads according to which regulation has the nearest, or tightest, compliance deadline. But as regulatory change teams increasingly juggle more regulatory balls, they are finding it difficult to achieve sufficient coordination. Firms with highly decentralised, or federated, business models have found implementation especially tough.

"The volume of [regulatory] work has changed. There is much more structure and documentation – especially around corporate recording of decision-making. This is in much more detail than before."

CFO, international syndicate, international insurance organisation

"One key issue for us is growing protectionism on a national, country-by-country basis. We see supervisors creating barriers to entry – requiring greater capital within each country. Expanding in LATAM is difficult because of this."

Regional Executive Director, international insurance organisation

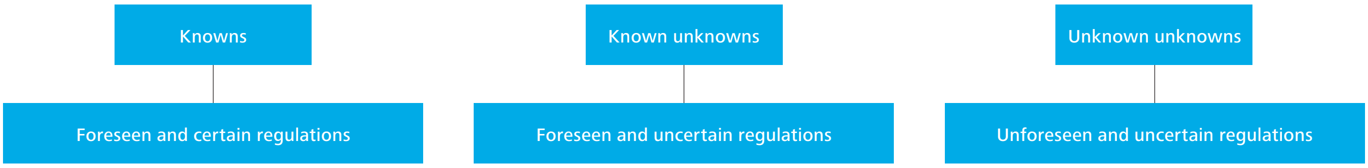
"Each regulator takes its own view on Solvency II! Implementation at national level can look very different – even in seemingly harmonised legislation."

CEO, major international French insurer

Uncertain regulatory agenda has caused planning difficulties

European insurers have been subject to many 'unknowns' in the new regulatory landscape. Dealing with such regulatory uncertainty is clearly a key issue for interviewees and a major challenge in making business decisions. When regulatory details are certain, insurers can plan for them, but where many variables are 'known unknowns', planning becomes difficult.[13] Much regulation has been subject to revision, from implementation timelines to changing specifications and interpretations.[14] The volume of regulation and supervision that is 'foreseen but uncertain' has increased. In addition many insurers think they are at greater risk of 'unforeseen and uncertain' regulations – the unknown unknowns (see Figure 4).

Figure 4. Degrees of regulatory certainty – classification of insurance regulations



Source: Deloitte Insight, 2013

Regulatory uncertainty has negative consequences for compliance and strategic planning

Senior decision-makers are grappling with regulatory uncertainty, and can suffer from a form of strategic paralysis where regulation is a key variable.

When regulations or supervisory decisions are important to the direction of firms, but are not yet set in stone, interviewees suggested it is difficult to accommodate them in business planning, strategic thinking and capital allocation decisions. Many insurers adopt a 'wait and see' approach when business decisions are contingent on regulation.

Regulatory uncertainty also affects the way in which regulatory and compliance functions are treated within the firm. Most interviewees think it is risky to be a first mover on regulatory change. With regulations capable of creating large shifts in the competitive landscape, some insurers in our sample have had to perform strategic U-turns when they have wrongly anticipated upcoming changes.

"Regulatory uncertainty is a problem – Solvency II is killing European M&A and we can't do it until the Solvency II capital requirement implications are clear. M&A is paralysed. The industry needs some consolidation – but it can't do it right now."

Global Strategy Director, large global life insurer

Regulatory volume and uncertainty here to stay

Interviewees feared that the regulatory landscape will continue to see increases in protectionism and uncertainty following recent financial crises. This makes it difficult for global insurers to standardise implementation and undermines economies of scale.[15] When global growth strategies rise up the strategic agenda for European insurers, harmonisation will become even more important as insurers seek to avoid any brake on their global growth ambitions.

Interviewees did not state their views for how certain or uncertain regulation will be. However it is clear insurance companies in many European states face significant new sources of uncertainty. For example, many European states are reshaping their roles in relation to state provision of insurances such as pensions and retirement provision, long-term care and flood risk.

"The group function, in terms of global coordination of regulation, can only deal with one problem at a time in our compliance model – due to our federated model with a very lean group level. Internally, we do suffer from sequencing issues."

Global Strategy Director, large global life insurer

What could supervisors and regulators do to ensure smoother adoption of regulation?

One of the tasks of The European Insurance and Occupational Pensions Authority (EIOPA) is to establish high quality common regulatory and supervisory standards in the EU. EIOPA's powers include issuing guidelines and recommendations, and developing draft regulatory and implementing technical standards. For Solvency II, it has opened consultation on four sets of guidelines which seek to bring forward the implementation of certain Solvency II requirements to 1 January 2014. EIOPA is seeking a more consistent and convergent approach to Solvency II preparation across EU member states. In the absence of a political agreement on Omnibus II, National Competent Authorities (NCAs) may individually take interim (and possibly inconsistent) regulatory measures. European and national supervisors should:

- Understand the role of certainty/uncertainty in insurers' regulatory and business planning.
- Monitor closely their effect on duplication/volume of insurance regulation.
- Redouble efforts to harmonise supervision/implementation so that multinational insurers can achieve synergies in dealing with multiple regimes – or at least not be disadvantaged by the multiplier effect of local jurisdictions ramping up requirements.
- Make concerted efforts to avoid protectionist behaviours at national level –to facilitate standardisation of responses (and best practice) by insurers'.
- Spend more time assessing the cumulative impact of regulation and overlaps in requirements.
- Consider limiting the number of supervisory bodies and codes (or at least take steps to avoid proliferation).

The political environment is crucial in setting the direction and degree of change in insurance regulation. Politicians have never been so involved in insurance regulation, and insurance supervisors and insurers now deal extensively with politicians in deciding technical insurance issues. Still, more time needs to be given to communicating with politicians and improving their understanding of the impact of regulation on the insurance sector and the scope of unintended consequences.

"Uncertainty in regulation is key – it might all change by the time we get there! … Where there is regulatory certainty we find it easier to make plans – think strategically. Where there is regulatory uncertainty the question becomes 'how to deal with it?' This is where we have to resort to tactics".

Group CRO, major UK insurer

New capabilities required as regulation 'plays out'

With regulatory volume and uncertainty dominant themes in insurance regulation, the activities of regulatory change and compliance teams are widening in scope.

Gaining a thorough understanding of the dimensions of each new regulation by level of certainty is a new necessity for insurers. Categorising which are the 'knowns', 'known unknowns' and 'unknown unknowns' can help insurers determine their next steps. Specifically, insurers are increasingly required to develop four capabilities:

- Clarify levels of uncertainty (gain clarity on the status of regulatory changes).
- Plan on certainties (make plans on aspects of regulation which have a high probability).
- Forecast anticipated uncertainties (build scenarios for less-defined aspects of regulation on the horizon).
- Absorb uncertainties (a flexible, rapid-response to unforeseen regulatory change).[16]

Figure 5. Four capabilities required for the new regulatory environment

Regulatory certainty		Knowns Foreseen and certain regulations	Known unknowns Foreseen and uncertain regulations	Unknown unknowns Unforeseen and uncertain regulations
Capabilities required	Clarify levels of certainty	Planning on certainties	Forecasting on anticipated uncertainties	Absorbing uncertainties
	Interpretation/ monitoring	Coordinated implementation	Scenario planning	Build flexibility and minimise regulatory exposure
Description	**Clarify levels of certainty** Regulatory portfolios are often not monitored sufficiently to understand, a) the certainty with which a regulation will be implemented, b) the detail of implementation, and c) the direction in which the regulatory agenda is likely to travel. **Interpretation/monitoring** Interpretation and monitoring activity is vital in creating higher levels of certainty around regulation. Early warning systems and greater intelligence on regulation will lead to more informed management of, and influence over, the regulatory agenda. Having the right data is the backbone of regulatory planning.	**Planning on certainties** There are many instances where regulations or key details of regulation are definite. However, the cost of implementation is needlessly high because each regulation is implemented through its own silo and few overlaps are spotted, resulting in 'execution stretch'. **Coordinated implementation** Better planning and coordination is required across the full portfolio of regulation. Insurers and regulators need to analyse the implementation agenda to spot overlaps and common themes from which synergies can be derived.	**Forecasting on anticipated uncertainties** Insurers are subject to many known regulations which have uncertainties, but can fail to include them in strategy due to their propensity to change. Insurers are experts in assessing risks and planning for them, but rarely apply those skills to the regulatory agenda and internal regulatory change and compliance issues. **Scenario planning** Better use of scenario planning techniques (such as 'what if' testing) would facilitate inclusion of regulation in strategic planning and corporate strategy.	**Absorbing uncertainties** Where insurers cannot plan for regulatory change due to uncertainty, they should be in a position to absorb uncertainties. A lack of coordination in regulatory change and compliance functions means responses can be slow and inflexible. Insurers can be organised in a way which subjects them to a greater number of regulations than is necessary. **Build flexibility and minimise regulatory exposure** Insurers should create greater internal flexibility in change and compliance functions so they can react more rapidly. Insurers can reduce unknown regulatory risks through restructuring parts of their operating models.

Source: Deloitte Insight, 2013

Regulators and supervisors can play their part in mitigating some of the regulatory challenges such as the 'multiplier effect', 'execution stretch' and uncertainty regulators (see Figure 6). But insurers may also need to establish new approaches to cope with the regulatory agenda. Some firms use analytical tools to help them identify the most certain aspects of regulation and supervision and plan accordingly. The next section discusses the obstacles to implementing their response to the evolving regulatory landscape.

Obstacles to a new approach

Regulatory change and compliance functions need enhancements to accommodate the new requirements

Expectations are for regulatory change and compliance functions to deliver

Teams responsible for delivering regulatory change and compliance face significant additional demands. Regulation is reaching further into insurance processes: it has increased globally and carries much greater uncertainty. Regulatory change and compliance teams are under increased pressure to identify overlaps and efficiencies across multiple, often unconnected, regulatory programmes. They must monitor and interpret shifting regulatory requirements and manage how potential changes impact the business and its strategic plans. They must also respond rapidly when regulatory details are finalised and a course of action is decided.

Insurers have gone to considerable effort to keep up with new change and compliance requirements. Spending on such change and compliance programmes has risen significantly in recent years, and compliance teams have also increased in size and resources. However, Deloitte argues that in many cases regulatory change and compliance teams remain ill-equipped to respond. Such teams have not been developed to accommodate the new demands and a more coordinated approach is required.

Obstacles to developing a new approach

Through interviews, Deloitte observed two main obstacles to higher performance in regulatory change and compliance teams. First, few insurers have a single view of regulatory change against which they can plan effectively; and second, regulatory competencies and insights are poorly represented in strategic decision-making.

While there are examples of best practice among some insurance companies, many teams responsible for regulatory change and compliance operate in silos – focusing on a single regulation. Integration and coordination across teams are difficult. Several interviewees indicated that synergies, duplications or gaps between regulations may only come to light at the risk and audit committees level. The process may be informal (for example, based on open conversations between leaders) and regulatory compliance risk is just one issue on an extremely full agenda.

To improve the regulatory change and compliance response, there are eight obstacles to overcome (shown in Figure 6).

"Regulation is an overhead. You might not go into a country because the regulatory burden is high. But on the whole it's just an overhead; a cost of doing business."

Regional CEO and group board member, major global insurer

Figure 6. Eight obstacles for insurance regulatory change and compliance functions

Obstacles for insurance regulatory change and compliance functions	
1.	**Cost is king.** Traditionally limited remit for regulatory change and compliance functions has kept them cost-focused and under-invested.
2.	**'Execution-stretch'.** Under-capacity, where teams continuously operate at maximum, leads to 'one-at-a-time' implementation.
3.	**Coordination.** Disparate ownership of the regulatory change agenda creates implementation inefficiency.
4.	**No holistic view.** Without an overarching view of regulation, synergies may be missed and there is a material risk of sub-optimal implementation.
5.	**Analytical capabilities.** Regulatory change and compliance teams may fail to apply their data effectively without the analytical capabilities to build regulatory and business-based insights.
6.	**Poorly-defined impact.** The impact of regulation can be poorly measured, undermining its status as an 'environmental' factor in scenario planning and formulating strategy.
7.	**Regulatory leadership.** Insufficient 'C-suite' skills, communication and leadership from regulatory change and compliance functions could mean that strategic decision-makers have been insufficiently supported or do not make best use of their internal regulatory experts.
8.	**Wait and see.** Uncertainty makes strategic decision-making challenging and may result in a 'wait and see' approach. A new set of planning skills is required.

Source: Deloitte Insight, 2013

"Very few people [within the organisation] are aware of each regulation, how they overlap and how they are superseded."

Finance Director and Board Member, international French business

Cost is king

Some of the senior executives interviewed perceived regulatory compliance primarily as a cost, with little upside or first mover advantage to be gained from investment. This means that regulatory functions may be given 'operational' aims, for example to achieve compliance with minimal spending and disruption to the business plan (rather than contribute expertise to strategic decision-making). This could mean that regulatory change programmes are under-resourced, given the size of their new task list.

'Execution-stretch'

Lack of capacity in regulatory change and compliance-related teams is cited as a significant factor in insurers' ability to execute the current agenda. Such teams often operate at maximum capacity, impairing their ability to implement multiple regulations simultaneously and enterprise-wide.

When under-capacity meets excess demand, it creates a drag on performance. Based on interviewee responses, it became clear that highly resource-constrained functions are more likely to operate on a 'one-at-a-time' basis. The regulatory compliance agenda is often reactive and prioritised solely on implementation timelines. This appears to be amplified where 'lean' group functions are required to implement regulatory change in a decentralised operating model.

Coordination

It is clear from interviews that the owners of regulatory change and compliance agendas may be located in different parts of the business, and there is no industry standard or approach to deciding which roles should be responsible for driving through key pieces (or thematic groups) of regulation. Solvency II may be led by the CFO, FD, CRO or MD of a specific business unit, or even a regional CEO. They receive inputs from many functions (including information technology, legal, human resources and business unit controls) and various geographic locations.

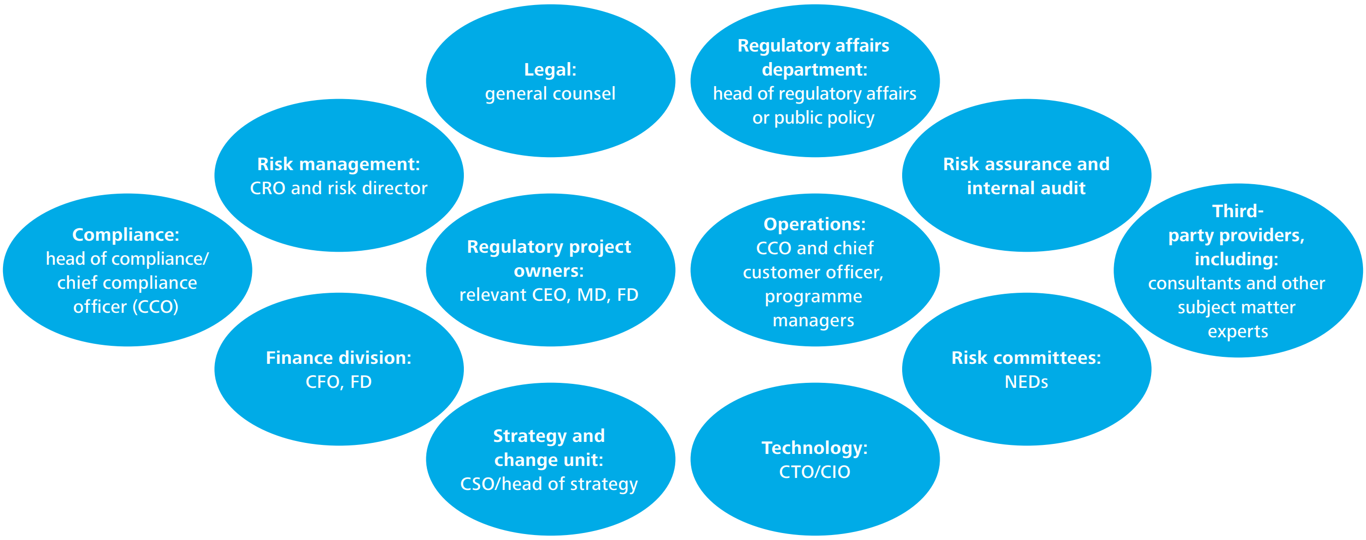
While such ownership can facilitate focus and drive in implementation, it may also create coordination difficulties and teams may speak different business languages, depending on their perspective. Poor cooperation between regulatory change and compliance teams means it can be difficult to deliver best practice, monitor overlaps and synergies between regulations, and identify enterprise-wide compliance risks and solutions.[17]

"The group function, in terms of global coordination of regulation, can only deal with one problem at a time (due to our federated model with a very lean group level) in our compliance model."

Global Strategy Director, large global life insurer

Figure 7. Speaking different languages – illustration of actors in regulatory change and compliance programs

Responsibility for regulatory change and compliance is often spread across a number of disciplines, business units, functions and 'lines of defence'. These include:



Compliance-related functions struggle for coordination at the global or functional level.

Source: Deloitte Insight, 2013

No holistic view

Many of the insurers we interviewed did not have a comprehensive view of their regulatory risks and responses or the full impact of the regulatory agenda. As a result they may fail to spot overlaps, risking 'digging up the road again'. Many survey participants indicated a single view is occasionally available in some form (for example when leaders discuss overlaps at risk and audit committee level) but few insurers have sufficient data and processes to support these high-level committees with good quality data in their coordination of regulations.[18]

Analytical capabilities

Risk management data has improved significantly in recent years. Some interviewees said adherence to new regulatory standards (especially SII) has been instrumental in this. However in Deloitte's view, the regulatory risk data and intelligence required to improve strategic decision-making has been generally insufficient.

Organisations without the appropriate capabilities to interpret and monitor the regulatory landscape, and understand the business implications of such regulatory intelligence, will be severely restricted in their ability to create a more coordinated response to multiple regulations. Their regulatory change programmes are likely to struggle with 'sequencing issues', where regulations are implemented with less coordination.

Poorly-defined impact

The impact of new regulation is often seen by senior insurance executives simply as a 'cost of doing business'. There are two ways in which insurers underestimate the business impacts of regulation. First, due to the absence of a unified view of regulation across the enterprise, regulatory costs are difficult to measure and define – and so are likely to be underestimated. Second, its wider business impact is even more difficult to measure and is therefore often overlooked.

This could be highly material to the way in which regulation is treated in scenario planning. When considered in scenario planning processes, regulation is likely to be underestimated as an environmental factor in the first stage of scenario planning – 'environmental analysis'. According to respondents, many do in fact include regulation as an environmental factor in scenario planning. However regulation can fall out of the planning process when building scenarios. This is because regulation is rarely defined holistically enough to count as a sizeable 'structural' trend for which insurers can make explicit plans (see Figure 13).

Without the data and analytics to measure its impact, regulatory change and compliance-related functions are unable to support decision-makers sufficiently, either in setting the enterprise-wide response of their firms or in formulating long-term business plans grounded in regulatory analysis.

"Including regulatory factors in the strategic planning process – happens but it is certainly not a refined process."

Regional CEO, major global insurer

Regulatory leadership

Senior executives admitted that increasingly they are required to make strategic business decisions based on regulatory variables. For example, increasing capital and liquidity requirements reduces returns on equity and so requires executives to make decisions with regulation in mind. Executives must also make decisions about the response to regulation – defining their firm's regulatory approach in the light of its business impact, complexity, uncertain timelines, overlaps and scale of investment required.

Several senior insurance leaders indicated they need more information and greater clarity on some regulatory issues in making these types of decisions. The fact that some strategic decision-makers are struggling with regulatory decisions may be simply due to the fact that regulatory change is so uncertain. However it is also likely that internal teams of regulatory experts have not supported their senior leaders and strategic planners with sufficient regulatory intelligence and decision support.

There could be many reasons for this, ranging from underinvestment to lack of capacity, but several insurance leaders commented on the skills-base of regulatory change and compliance-related functions. Some interviewees indicated that while their regulatory experts have become more competent in many ways, their communication, decision-making and business leadership skills are not at 'C-suite' level. This is likely to be a contributory reason why regulatory issues fail to climb the strategic agenda to influence senior decision-makers.

Wait and see

Few insurance leaders feel comfortable being the 'first mover' where actions are dependent on regulatory decisions. However without the correct apparatus for regulatory decision-making, business planners and senior leadership have had to take a view. Sometimes they have correctly judged the impact of regulation on business plans, but other times they have been forced to change tack or make U-turns. Due to heightened uncertainty in the regulatory landscape, strategic decisions are challenging, and many decision-makers appear to avoid decisions involving regulation until they are absolutely necessary. Often, they adopt a 'wait and see' approach.

Decision-making among compliance staff is difficult … the conclusions they provide are not very clear when I need to make a business decision … so business leaders (rather than compliance) have to take responsibility."

Finance Director and Board Member, international French business

A coordinated approach could reap business benefits

It is clear that insurers have spent significant sums on regulatory change projects. However fewer appear to have restructured their central coordination of regulatory change and compliance teams. In order to obtain a business dividend from the €4.2 – €4.9 billion of costs incurred by the industry in 2012 greater coordination should be sought.

A more coordinated approach could bring significant benefits. As shown in Figure 8, these range from reduced total implementation costs and mitigated regulatory and compliance risk, through to minimised business disruption and improved transparency and insight.

Figure 8. Potential benefits of improved response to regulation

Delivery benefits

Reduce total implementation cost

A coordinated and single view of regulation can reduce high BAU and implementation costs.

- For a top 40 European insurer, the average costs incurred for new regulation for 2010-12 inclusive is in the range of €214 – €217million. A single view of regulation can show where operational redundancies and duplication between regulations exist.
- From this base, it is possible to consolidate regulatory initiatives to reduce implementation costs, facilitate economies of scale and free up time for more strategic input.

Mitigate regulatory compliance risk

A holistic and coordinated single view of all compliance risk enables executive level oversight and effective mitigation.

- Compliance gives implicit assurances to regulators, shareholders, customers and third parties. Without an overview of total compliance risks, insurers with breaches are risking significant reputational risk, fines and remedial costs.
- Better-coordinated regulatory functions can help to manage compliance risks, associated costs and wider impacts.

Reduced performance drag

The wider impacts of regulation can create a performance drag, which can be reduced by a new approach.

- Impacts range from high implementation costs to largely unmeasured costs such as business unit leaders' distraction from financial and performance metrics.
- Better-coordinated regulatory functions (capable of measuring the actual cost of regulation), could impact the bottom line by reducing costs from more efficient implementation and allowing business leaders to focus on performance objectives.

Board benefits

Strategic alignment of regulatory functions with board

Aligned, high quality compliance support can help boards take decisions dependent on regulatory variables.

- Decisions subject to uncertain regulations are often avoided, or taken without reference to regulation. This can lead to strategic paralysis or U-turns where compliance requirements are an afterthought.
- Senior leaders of regulatory 'air traffic control' can help boards take more informed strategic decisions.
- Regulatory-driven changes to culture, incentives and rewards can be at odds with business objectives unless strategically aligned.

Minimise business disruption

Business disruption caused by regulation can be minimised by better managing regulatory change.

- Projects and lines of business may be halted or changed in response to regulatory requirements. Management time and other investments can be diverted away from business objectives like growth.
- Improved regulatory planning, aligned with wider business change initiatives and BAU plans can reduce such disruptions. Better-coordinated and more 'strategic' regulatory functions can plan for, and anticipate, disruptions.

Improve transparency and insight

Coordination of the regulatory approach can improve transparency for wider business benefits.

- Stakeholder confidence in insurers can be low due to perceived opacity of performance data. Better transparency and stakeholder relations can be achieved by coordinating and levering regulatory functions and their data.
- Improved reporting of data produced by regulatory and compliance units may be coordinated to generate insight for business decision-making and investor relations.

Source: Deloitte Insight, 2013

Rethinking the insurer response

Six disciplines required to build a new approach to regulation

Creating a new approach to the regulatory agenda is a significant undertaking. However, there are a number of disciplines that insurers can apply to improve their response. Some represent adjustments in current ways of doing things: others are more radical.

The six disciplines form part of Deloitte's regulatory planning approach – which has regulatory uncertainty at its core. An overview of the whole approach is represented in figure 9; the subsequent pages provide detail on each of the disciplines:

1. Coordination and governance.
2. Aggregated (single) view.
3. Regulatory portfolio management.
4. Scenario planning.
5. Absorb uncertainty.
6. Embed a new modus operandi.

Some insurers are working on individual elements of this approach. Front runners are finding ways to improve collaboration and integration across regulatory and compliance-related teams. Others are improving regulatory intelligence (data). According to our interviews, some insurers are advanced in several of these areas while behind in others.

The starting point for more extensive change will depend on each organisation. In determining how to proceed and what to prioritise, working out the overall regulatory approach is essential. Deloitte brings together the six disciplines into a single approach to regulation. This pull-out illustrates Deloitte's regulatory planning approach for regulation.

Deloitte's regulatory planning approach

Figure 9.

1

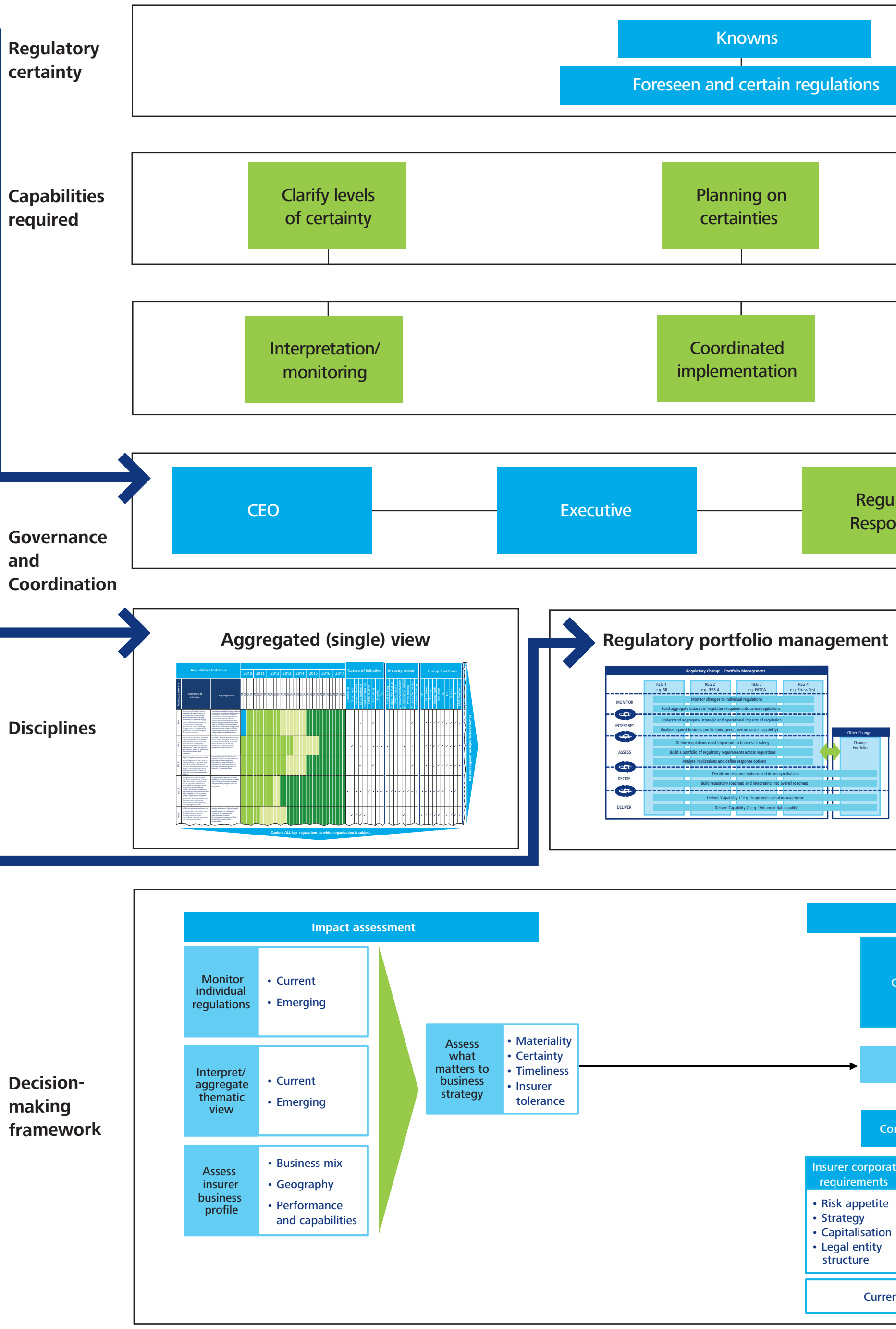
Coordination and governance. Establish a Regulatory Assessment and Response Executive (RARE) with a remit to achieve better coordination across the core regulatory change activities.

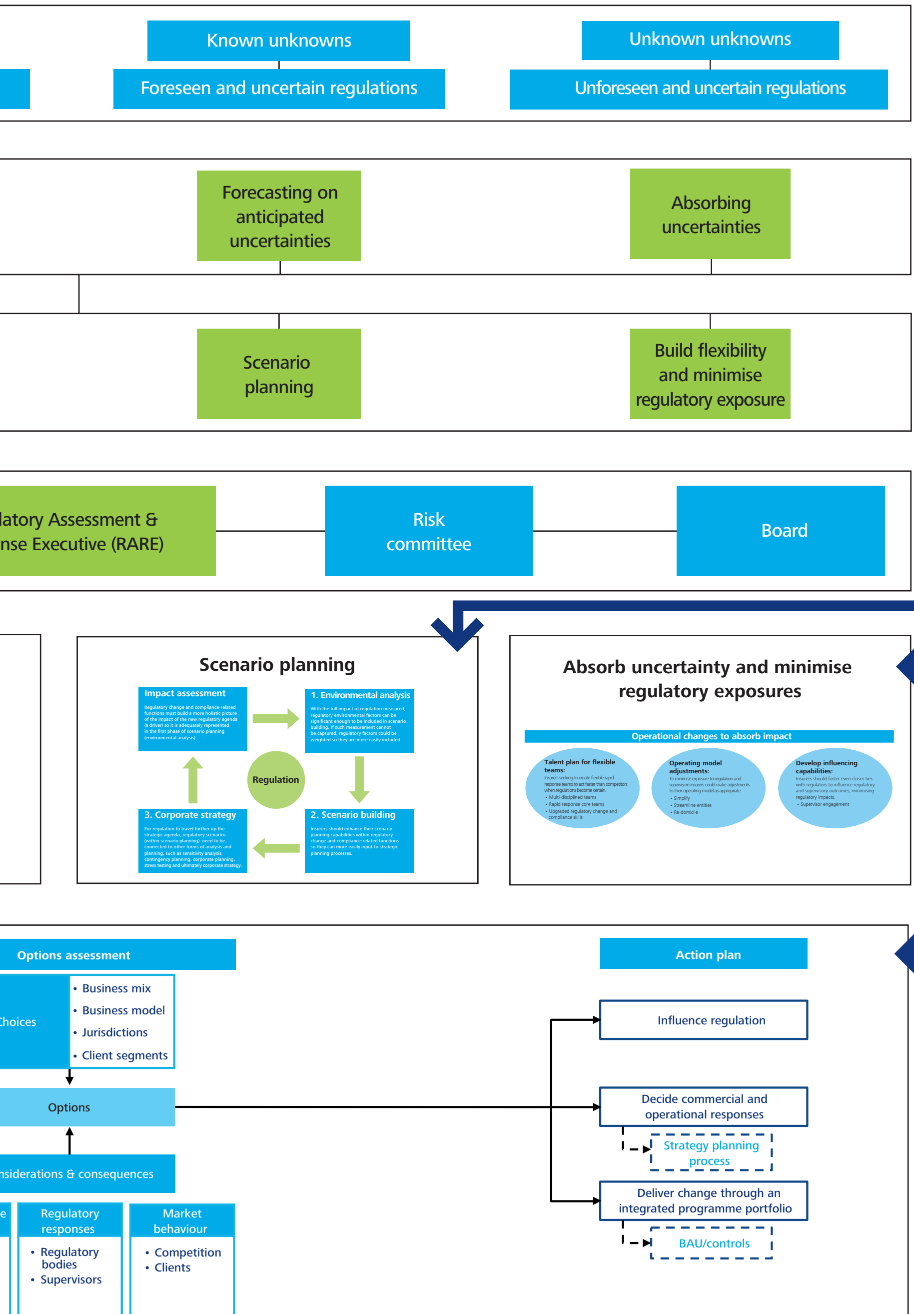
2

Aggregated (single) view. Create a single view of regulation across all regulatory change and compliance functions, through aggregated regulatory risk data and improved monitoring and interpretation of regulations impacting the firm.

3

Regulatory portfolio management. For the most foreseeable regulations, using a portfolio management approach can create a more coordinated response to implementation, taking into account themes across multiple regulations, other change initiatives and the firm's strategic objectives.





Source: Deloitte Insight, 2013

4

Scenario planning. For regulation that carries some 'unknowns', scenario planning techniques should be used to identify likely outcomes and bring regulation, and those functions dealing with it, more fully into strategic decision-making processes.

5

Absorb uncertainty. Where regulatory planning becomes too difficult due to the uncertainty of future regulatory and political developments, insurers can take several pre-emptive actions. These may include creating more flexible, rapid-response regulatory change and compliance teams for when regulatory factors do become apparent, or adjusting operating models to reduce regulatory exposures where possible.

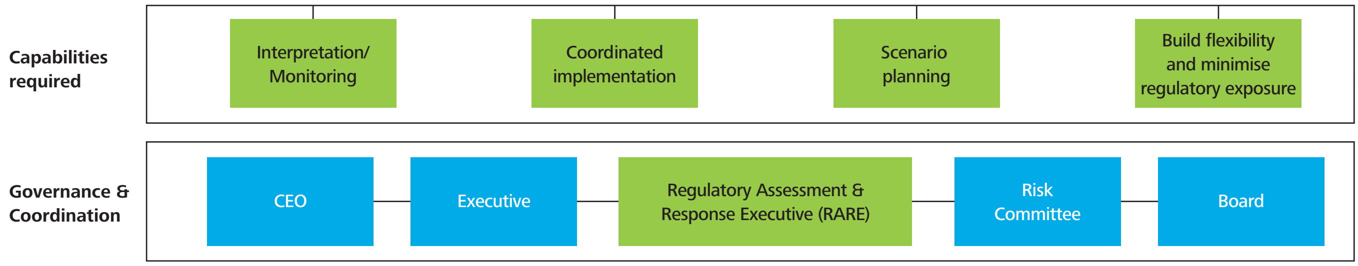
6

Embed a new modus operandi. For future regulatory decisions a new framework should be put in place to embed the whole regulatory decision-making process and guide strategic thinking where regulation is a factor. This framework will enable insurers to translate regulatory analysis into actionable plans.

The following pages break down the approach into its constituent parts.

1 Coordination and governance: a new executive unit (RARE)

Figure 10. Regulatory Assessment and Response Executive (RARE)



Source: Deloitte Insight, 2013

New regulation has left insurers stretched, uncertain and requiring new capabilities. These capabilities are shown as interpretation and monitoring; coordinated implementation; scenario planning; and flexibility/reduced regulatory exposure. Greater cooperation between often disparate and poorly integrated regulatory change and compliance functions is at the heart of the solution.

While insurers have invested significantly in individual regulatory change initiatives (e.g. Solvency II, MCEV, RDR in the UK), it is less clear whether some of this investment has been directed at coordinating these programmes as part of a firm-wide response to regulation. A new executive unit or role should be considered. A Regulatory Assessment and Response Executive (RARE) should be established to facilitate coordination and serve as a platform for regulatory change and compliance activities.

Its key remit should be to create synergies from a better-coordinated firm-wide response to the new regulatory agenda. It should develop the four capabilities. And it should provide a platform for regulatory change and compliance teams to form an enterprise-wide view of regulatory requirements and responses. The RARE should work closely with subject matter experts to obtain and share the knowledge and intelligence required to form multi-disciplinary, mobile and flexible teams. Figure 10 highlights the RARE’s core capabilities and illustrates where the regulatory executive should fit into the organisation structure.

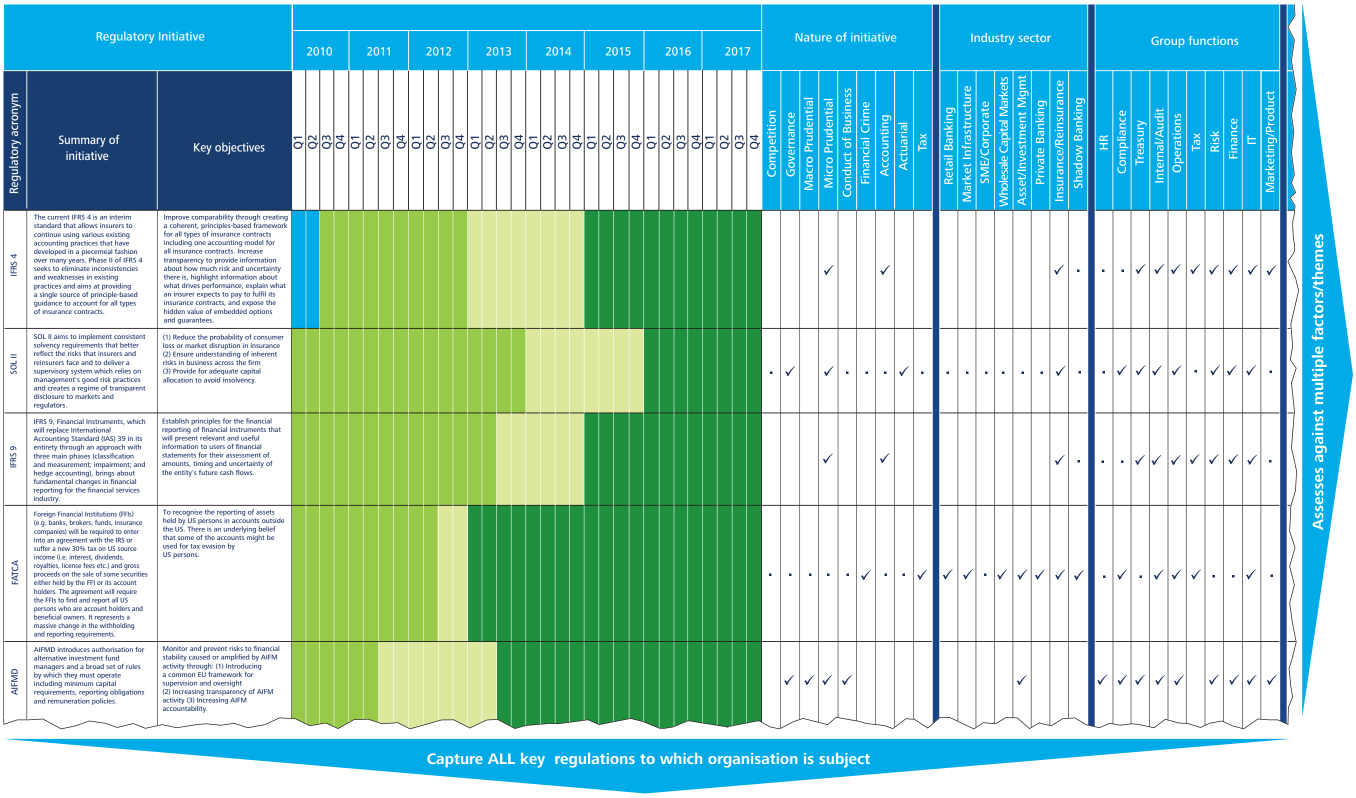
The structure of the RARE should mirror that of the firm in terms of organisation, degree of centralisation/ decentralisation, reporting lines, position within the three lines of defence model and linkages to other departments and functions within risk governance frameworks.[19] The RARE could form a discrete unit with dedicated resources to coordinate the firm’s response to regulation.

To align regulatory and compliance functions to the strategic objectives of the firm, the unit should connect meaningfully with the board. It should have the capacity to generate powerful insights and recommendations for the board, based on a firm-wide view of regulation. It could also contribute to a more robust governance model for regulatory and compliance functions.

Many of the skills required to create a RARE unit may already exist within insurance companies. For example, interpreting and monitoring the regulatory agenda may be specific to regulatory and compliance-related functions while skills such as risk assessment, scenario planning, leadership and communication may be found in other divisions and functions. If insurance firms choose not to build a specific unit, they should assess how they can carry out similar activities with the resources and skills at their disposal.

2 Aggregated (single) view: monitoring and interpretation

Figure 11. Regulatory intelligence and assessment: an aggregated thematic view across regulations



Formulation of a regulatory initiative i.e. a white paper or formal consultation has been issued for comment

Legislative process underway

Period of firms readiness for implementation prior to requirements being in effect

Start of requirements is in effect i.e. application

Timeline unclear or forming

Source: Deloitte EMEA Centre for Regulatory Strategy, 2013

Building regulatory intelligence is key to clarifying which regulations, or aspects of regulations, are certain (around which plans can be made) and which are uncertain (requiring a different approach). It is also a foundation for a single, aggregate view of regulation. Regulatory intelligence-gathering and analysis is built on two concepts: monitoring and interpretation.

- **Monitoring:** Insurers require a dynamic dataset that plots key regulatory and supervisory developments. Regulatory intelligence should ideally cover key areas for each regulatory development, such as timelines, level of certainty and business lines, functions and processes likely to be affected. The information should include relevant updates in all parts of the business to give an aggregate, enterprise-wide view of current and emerging regulation.

- **Interpretation:** From this database of regulatory information, insurers should build a consolidated view of the strategic and operational impacts of the regulations. 'Interpretation' requires insurers to understand the potential regulatory overlaps, synergies and themes to impact the business. Some insurers are building early warning systems that interpret regulations across their businesses and give a red, amber and green (RAG) gauging progress against the regulatory agenda.

Figure 11 gives an illustration of the type of data tools used within Deloitte's EMEA Centre for Regulatory Strategy to build an aggregated view of regulation.

Cross-functional ways of working may be required to facilitate regulatory intelligence-gathering. For example, to pull together aggregate data, there must be contributions from many teams and functions involved in regulatory change and compliance. Central coordination may be required to increase coordination across the functions, divisions, business units and geographic locations. Such teams must also be led and incentivised for this change. See the fifth discipline in this section on 'absorbing uncertainties' for more detail.

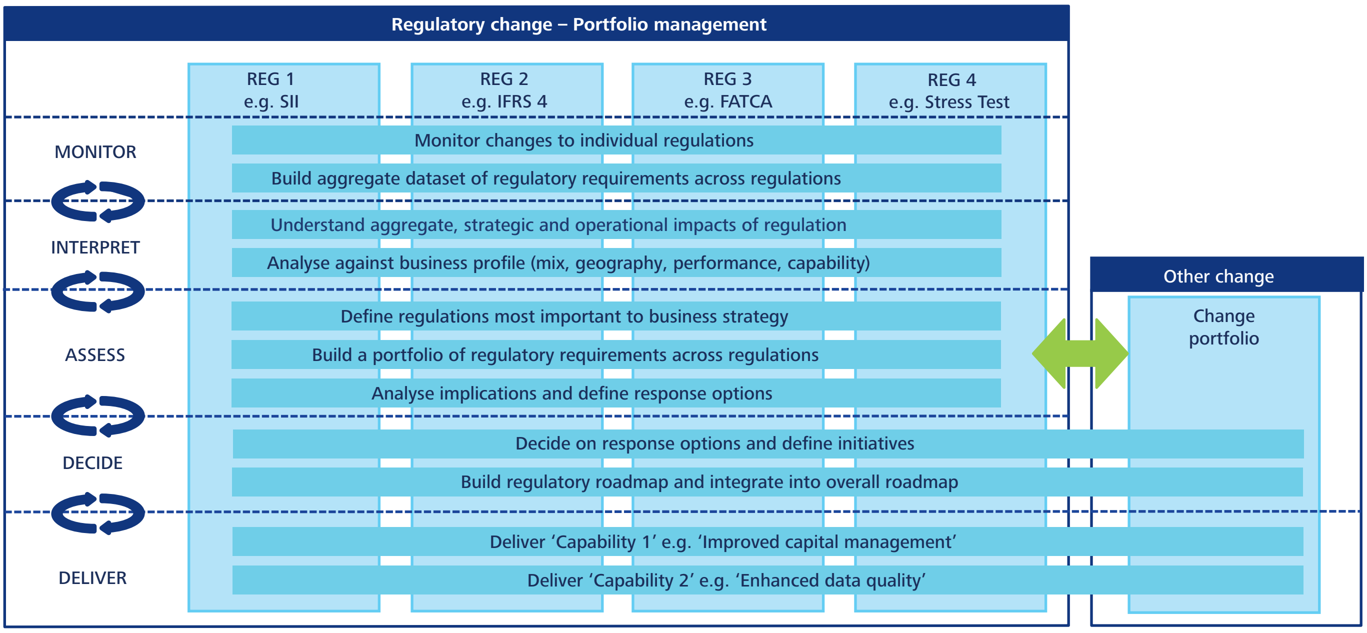
External data sources and intelligence will also be required. Insurers will need to maintain (or improve) links with supervisors and regulators and third-party regulatory experts. In addition, European and national industry associations (such as ABI, GDV, FFSA) should play a greater supporting role in building regulatory intelligence and monitoring for their members.

"We do talk about overlaps among regulations at the exec risk committee, and I think we are pretty good at it … However is there a systematic approach? No. There is no system – and there is no analytical tool which helps us identify overlaps. We just talk to each other."

Executive Director, international insurance group

3 Regulatory portfolio management: planning on certainties

Figure 12. Coordinated portfolio management approach to regulatory change



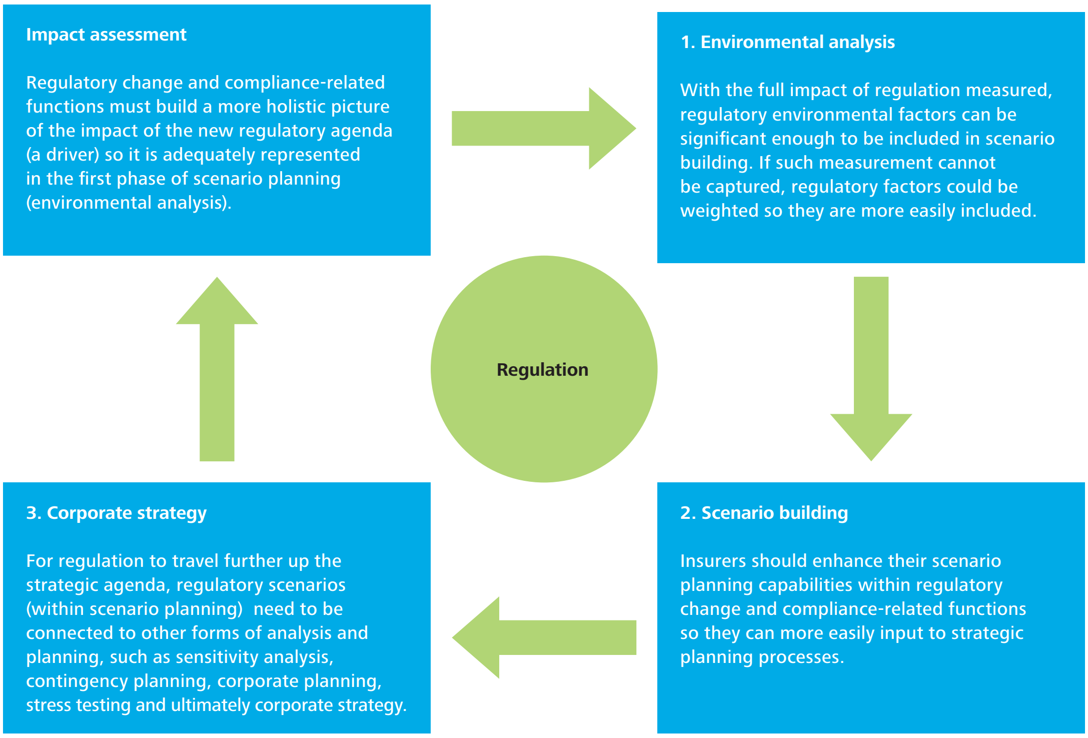
Source: Deloitte EMEA Centre for Regulatory Strategy, 2013

Where regulatory details have a good degree of certainty, portfolio management may be used to coordinate implementation plans. A portfolio management approach can identify where there are commonalities and overlaps. To achieve greater business benefits, the approach should be aligned with wider strategic change programmes and business objectives.[20] As shown in Figure 12, there are five stages to the Deloitte regulatory portfolio management process.

A portfolio management approach is a key tool in identifying and acting on synergies where regulation has a good degree of certainty. Stages 1 and 2 of the Deloitte portfolio management process in Figure 12 are concerned with generating regulatory intelligence. These phases are covered in the **monitoring** and **interpretation** processes outlined earlier. Three further phases are required: Stage 3 **assesses** regulatory impacts against business-based factors and the wider change portfolio to define the most important actions to prioritise. At stage 4 **decisions** can be made that are based on the whole regulatory change portfolio, building a roadmap to implementation. At stage 5 the roadmap can then inform the **delivery** phase, coordinated by themes (capabilities) commonalities and overlaps within the regulatory portfolio.

4 Scenario planning: planning for shifting regulation

Figure 13. Regulatory scenario planning process



Source: Deloitte Insight, 2013

Where regulation is uncertain, portfolio management becomes more complex. This is because the forecasting and planning required for portfolio management is challenging when working with uncertain regulatory details.[21] To ensure that they incorporate such regulation into the planning processes, insurers should make much greater use of scenario planning disciplines, so that uncertain outcomes can be more easily planned for.[22]

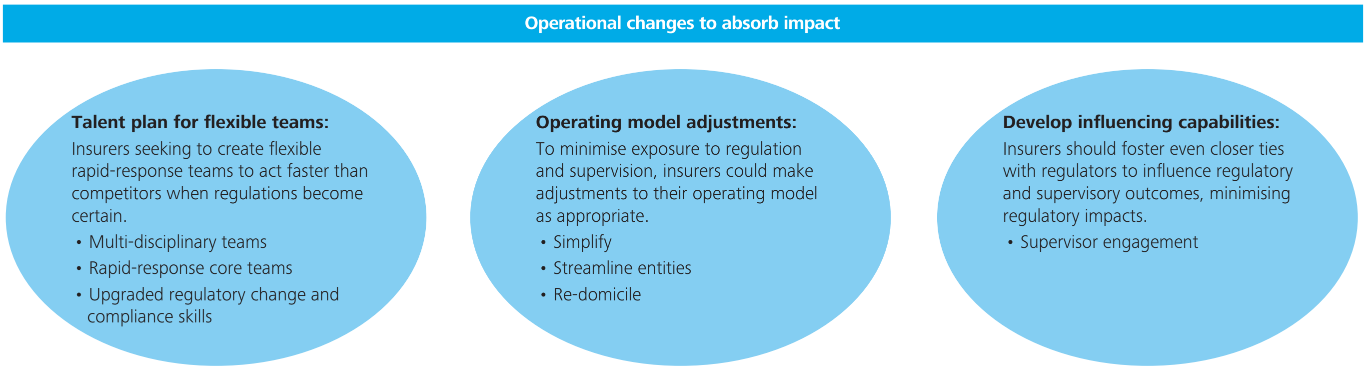
According to interviewees, many insurers are now incorporating the most significant regulations into their scenario planning processes. This is progress. However there is still a long way to go. It is clear that regulation can fall out of the scenario planning process in the 'scenario building' phase. This is because scenarios, typically built on the 'biggest', most significant drivers, may fail to recognise regulation as a key driver. This may be because the impact of regulation is not fully measured, and is therefore not regarded as a 'structural trend' of sufficient impact to be represented in the scenario-build phase.[23]

Regulatory change and compliance functions should develop their skills in scenario planning techniques so that they can create their own plans for uncertain regulation, and better understand how to represent regulatory issues in the wider business planning process. There are three stages in a scenario planning process where regulation could be better represented. These are illustrated in Figure 13.

To succeed in scenario planning, regulatory change and compliance functions must build a more accurate picture of the impact of the new regulatory agenda so that it is adequately represented in the first phase of scenario planning (environmental analysis). If such measurement cannot be captured, regulatory factors could be weighted so they are more easily included.

5 Absorb uncertainties and minimise regulatory exposures

Figure 14. Key actions to absorb and streamline regulatory uncertainties: 'unknown unknowns'



Source: Deloitte Insight, 2013

Regulations that are highly uncertain may be too difficult to include in the planning process. For these regulatory 'known unknowns', insurers should adopt 'absorb and minimise' strategies. To absorb such uncertainties, insurers can create flexible, rapid-response teams; and to minimise exposures, they can make operating model adjustments and develop influencing capabilities (see figure 13). We highlight three actions to support regulatory teams in building these capabilities. Some of the interventions represent minor changes while others are more radical.

Talent plan for flexible teams: To absorb uncertainty, insurers should create flexible rapid-response teams that will act faster than competitors when regulations become certain. This requires a talent plan specifically designed to 'enable' regulatory change and compliance teams. It should put in place:

- **Multi-disciplined teams:** A resource supply and demand plan for maintaining a flexible, multi-disciplinary teams. This should work with all regulatory change and compliance teams, whose culture should be 'enabled' for cooperation.' Practical steps might include redesigning objectives, key performance indicators (KPIs), employment contracts and rewards to incentivise agility, flexible working and coordination/cooperation. Knowledge-sharing, data pooling and best practice transference should be key goals. One leading insurer developed such an integrated approach emphasising the importance of retaining a FTE ratio of not less than 85%.[24]

- **Rapid-response core teams:** Resource policies must facilitate rapid-response. A crucial requirement is to retain institutional and regulatory knowledge and experience among these core regulatory teams. Where staff turnover is significant, institutional learning from one regulatory initiative to another can be lost and speed-to-act reduced. HR policies should have as an aim the maintenance of a strong and dynamic core regulatory team made up of individuals with significant experience in many parts of the business and, crucially, in more than one type of regulation. In addition, retained individuals can build and lever networks to act quickly with colleagues across the organisation. For example sabbatical policies can keep a flexible, highly skilled labour force engaged and retained.

- **Upgraded regulatory change and compliance skills:** The skills required to master regulatory change and compliance activity are changing. Insurers should define the skills and attributes required to perform the new core activities of the RARE, and assess the available pool of core and flexible workers in present teams. In addition, developing 'C-suite' stakeholder management capabilities among regulatory change and compliance leaders is crucial. For example, in some organisations regulatory and compliance functions need improved communication and planning skills – so that they can speak the language of the C-suite.

Operating model adjustments: To minimise exposure to regulation and supervision, insurers should consider what adjustments could be made to their operating model. Insurers have several options open to them:

- **Simplify:** Complexity in operating models may lead to duplication of regulatory change and compliance teams, and slow down the change process. Many of the leading firms among our interviewees were highly integrated and could move quickly because they had relatively simplified models (for example, fewer lines of business, simplified operating structures, fewer channels to market).

- **Streamline entities:** Some insurers are streamlining legal entity structures, minimising the number of supervisors to which they are subject.

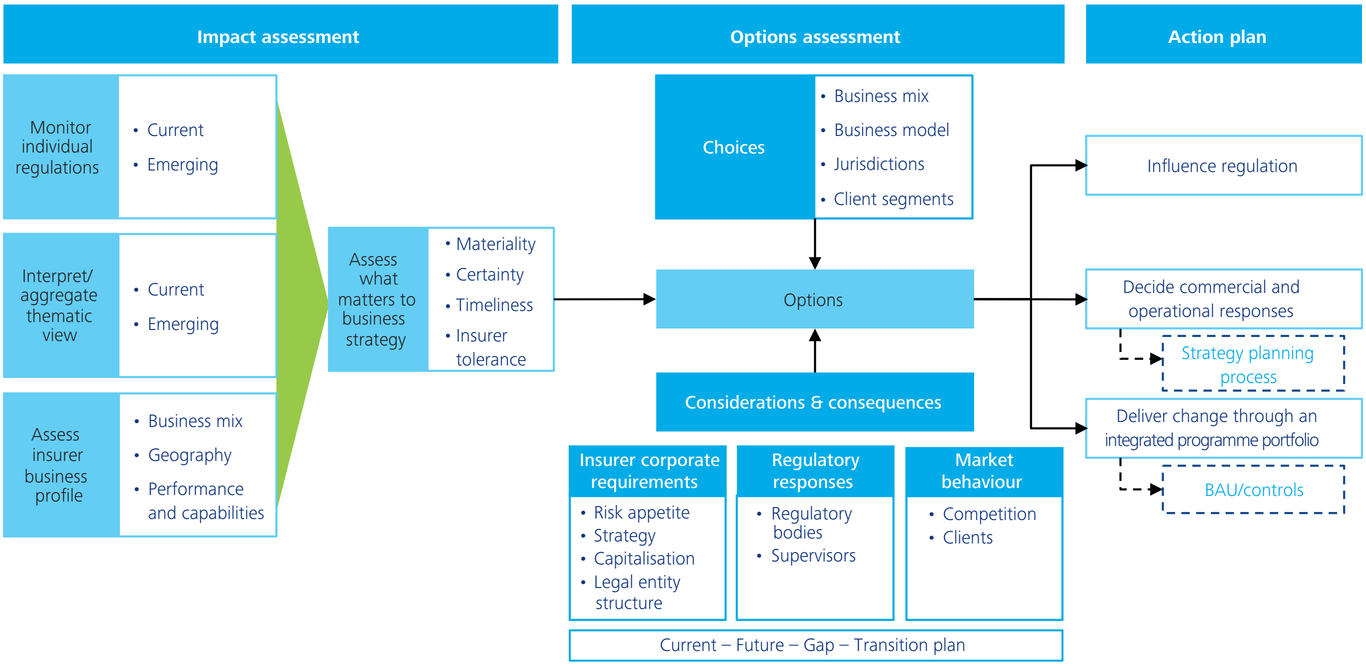
- **Re-domicile:** Insurers faced with regulatory uncertainty can domicile their headquarters in a country with a more stable regulatory environment. Several European insurance firms have publicly announced that this is an option they are considering.[25]

Develop influencing capabilities: Insurers should foster even closer ties with regulators to influence regulatory and supervisor outcomes.

- **Supervisor engagement:** Closer ties with supervisors will help minimise regulatory risks in two ways. First, it may help build data for improved monitoring and interpretation. Second, it can help insurers influence the regulatory agenda by creating better understanding of all stakeholder perspectives and by informing politicians, regulators and supervisors of the impacts and possible unintended consequences of proposed insurance regulation.

6 Embed a new modus operandi

Figure 15. Deloitte's regulatory decision-making framework ('SHARP framework')



Source: Deloitte EMEA Centre for Regulatory Strategy, 2013

Increased regulation is a long-term structural trend. Regulation is here to stay and will continue to evolve, with both certain and uncertain regulations. Deloitte recommends that insurers adopt a regulatory decision-making framework to embed good practice as a process – a more strategic way of thinking for all regulatory decision-making. The framework is wider in scope than the portfolio management approach highlighted earlier, which is used to coordinate implementation of regulations which are certain. To help embed good practice, Deloitte's 'SHARP' regulatory framework outlines the three elements required for regulatory decision-making:

- **Impact assessment:** Based on the 'monitor, interpret and assess' components described earlier, insurers should check that the impact of each regulatory variable in question is considered against business requirements and strategies, taking into account what matters most to the business. Using the framework will help insurers develop and maintain regulatory intelligence and assessment capabilities, produce aggregated thematic regulatory views across regulations, and understand how these map to insurers' business profiles and objectives.

- **Options assessment:** A series of regulatory options and priorities should be considered, taking into account the business context and external competitive factors. This requires a wider perspective, comprising an insurer's corporate requirements (for example, risk appetite, capital, strategy and legal structure), regulator responses and market behaviour (such as competition and clients). It is necessary to involve key stakeholders in understanding how commercial and operational requirements are linked to regulatory requirements and changes in market behaviours.

- **Action plan:** A number of potential actions are likely to arise from the 'options assessment' process. Options presented to senior leaders must be prioritised within the context of the firm's strategic framework, leading to decisions in three areas: influencing the regulatory and supervisory agenda, deciding a commercial response, and defining a regulatory action programme.

By establishing and following such a decision-making framework, insurers can distil best practice, share it across the firm and embed a new approach to regulatory change and decision-making.

Conclusions: Planning in the face of regulatory uncertainty

Since the financial crisis, regulatory change has become an important management challenge for European insurers. It has cost the European industry billions of euros and will continue to be a challenge for the foreseeable future. This report has attempted to distil solutions to the key regulatory issues that insurance leaders face: namely, the unprecedented high volume of new regulation and its increased uncertainty.

Supervisors have their role to play in fixing some of these issues. At the same time, insurers should look to create a more coordinated firm-wide response to regulation. This is the path to more cost efficient and effective implementation. In addition, they should look to accommodate regulatory change in strategic planning to make better, regulatory-informed decisions for the business as a whole.

At a time when regulation has become of crucial importance, there are tools and techniques that insurers can use to reshape their approach. We have set out six disciplines from which insurers can pick and choose according to their needs. Combined, these disciplines make a radical new approach to a thorny management challenge.

A more holistic view of the business impacts of regulation can help make an investment case for a new approach. This level of change is a significant undertaking, but, against this, a failure to reap business benefits from the heavy incurred costs associated with regulatory change should not be underestimated.

About this research

This section outlines the research methods used in this study:

Interviews

- Deloitte relied on a small sample of in-depth interviews with senior leaders, strategic decision-makers and business planners (e.g. CFOs, CEOs, Strategy Heads, General Counsel, or CROs with strategy, business planning or regulation responsibilities).

- We interviewed approximately 20 leaders, from 13 EMEA-based insurance companies, representing one third (31%) of the top 40 European insurance firms by GWP.

- Interviews were conducted between August and December 2012 – before Solvency II implementation timelines were reset.

- Questions were focused on two areas: 1) the challenges insurers face in optimising regulatory implementation and in incorporating regulation into strategy and 2) building a 'ground up' view of the scale and cost of the new regulatory agenda.

Regulatory costs analysis
To estimate regulatory costs for the top 40 European insurers and the whole industry we extrapolated data from a sample from 13 companies to 40. We carried out the following processes:

1. Gathered Solvency II cost data (sample 13): Prompted by a 'cue card' listing all the new regulations to which their organisation is subject, interviewees estimated their 2012 Solvency II costs. They also estimated the proportion of total regulatory spend represented by Solvency II.

2. Created regulatory cost ratios (sample 13): We combined the 13 Solvency II costs data points with published 2012 financial data for each of these companies (including operating expenses, NEP, equity). We then classified each insurer as small, medium, large (based on GWP), by domicile and major line of business (e.g. UK life, UK non-life, Europe life or Europe non-life). From this, we derived 'regulatory cost ratios' for each classification (for example, as percentage of equity, NEP or total operating costs).

3. Extrapolated cost ratios to the wider sample (top 40): We estimated the cost of Solvency II for each of the top 40 insurers by combining our Solvency II cost ratios with their financial data.

4. Estimated total regulatory spend: We extrapolated from our Solvency II costs to derive a total regulatory cost figure, by applying the average cost of Solvency II as a percentage of total regulatory cost (58 per cent). This produced six SII spend estimates for each insurance company. We took the average of the six as a best-estimate.

Regulatory cost impact analysis on ROE
To understand regulatory cost impact on insurers' bottom lines, the cost of new regulation was subtracted from PBT ROE. Two steps were taken:

1. Recalculated profit before tax ROE for each insurer, less total regulatory spend (from the above analysis).

2. Added total regulatory spend to pre-tax income and divided by average shareholders' equity.

Accuracy and validity of cost and ROE results:
Through r-squared testing, our cost estimates achieved a reliability/accuracy score of 67%, implying our methodology is reliable. However, we have two cautionary notes: our base sample is small; and many of our interviewees could only give approximations as to the total cost of regulation and the cost of Solvency II.

The following methodology was used:

1. Tested the accuracy of our regulatory cost estimates (extrapolations) by comparing the results generated by our model against the actual costs collected for 13 interviewees. This was done using the statistical methods of correlation, and coefficient of determination (r-squared test). The correlation test revealed that the cost estimates produced by our model were highly correlated to the actual costs (to the extent of +0.82 or 82%).

2. Used coefficient of determination to assess the reliability of our results (i.e. 67%).

Abbreviations

The following abbreviations were used in this report:

ABI – Association of British Insurers

AML – Anti-Money Laundering

ComFrame – Common framework for the supervision of internationally-active groups

CRD4 – Capital Requirements Directive 4

EEV – European Embedded Value

EIOPA – European Insurance and Occupational Pensions Authority

ESRB – European Systemic Risk Board

FATCA – Foreign Account Tax Compliance Act

FCA – Financial Conduct Authority (UK)

FFSA – French Federation of Insurance Companies

FTT – Financial Transaction Tax

GDV – German Insurance Association

IFRS – International Financial Reporting Standards

IMD – Insurance Mediation Directive

MCEV – Market Consistent Embedded Value

MiFiD II – Markets in Financial Instruments Directive II

PRA – Prudential Regulatory Authority (UK)

PRIPs – Packaged Retail Investment Products

RDR – Retail distribution review

SIFI – Systemically Important Financial Institutions (also includes G-SIFI, denoting 'global')

SII – Solvency II

Endnotes

1 Peter Drucker, 'Planning for Uncertainty', The Wall Street Journal (www.wsj.com), 1992. Peter Drucker argued for those things that are certain (such as a 'structural' trend) we can and should plan. But in times of uncertainty, planning is too tough and therefore being flexible and agile is key. Other theorists (such as Porter and Mintzberg) argue that firms need to get better at planning. In Deloitte's view, both schools of thought are valid when applied to regulatory challenges – insurers will find it useful to incorporate these ideas and perspectives when thinking through the challenges. See also 'Competitive Strategy', Michael Porter, 1980. See also, 'Patterns in Strategy Formation', Management Science, Vol 24, No 9, 1978, pp 934–948. Mintzberg, H. 1978

2 Insurer stress tests are a continuous process. We have counted it just once in this analysis.

3 Regulation from national regulators (as opposed to regional and international regulation) represents 31% of the total new regulatory burden for UK insurers, 33% for German and 38% for French (since 2010).

4 Top 40 as defined by gross written premiums (GWP), 2011.

5 The estimated cost of regulation for the top 40 increased by a quarter (23%) from 2010 to 2011, but fell to roughly the 2010 level in 2012.

6 In earlier Deloitte Insight studies, it has been estimated that senior leadership in financial services firms (including banks) can spend up to two thirds of their time on regulatory and compliance-based matters: 'Getting to Grips with Risk Governance and Controls', Deloitte Research, 2010.

7 Several UK divisions of global insurers are starting to see reduced new business sales due the ban on commission-based sales for advisors created by the Retail Distribution Review.

8 The increase in pace of regulatory change arguably began at the G20 conferences (summit) in 2009. These were to be the trigger points on how to address the stability of financial markets and regulatory reform for insurance through Solvency II.

9 Impact as measured in implementation and subsequent 'business as usual' (BAU) maintenance costs.

10 That is to say, 'foreign' to location of their headquarters.

11 Interviewees cited many different examples of this 'multiplier effect', from additional administration required for new licences to new capital buffer requirements in the jurisdiction and heightened customer protection policy.

12 Many interviewees (about half of the sample) perceive growing protectionism among supervisors and, in the UK, fear that 'gold plating' may achieve a similar outcome.

13 Donald Rumsfeld, US Secretary of Defense, 2001-06. Quoted in speech "There are known knowns; there are things we know that we know. There are known unknowns; that is to say, there are things that we now know we do not know. But there are also unknown unknowns – there are things we do not know we don't know."

14 For instance, on March 2013 the IAIS said that it would no longer consider applying an additional systemic risk capital charge to the entire balance sheet of globally systemically important insurers. Instead, capital add-ons will be calculated against 'non-traditional' activities only.

15 Some industry commentators suggest that the trend represents a loss of advantage for global or diversified insurers.

16 D. J. Hickson, 'A Strategic Contingencies' Theory of Intraorganizational Power', Administrative Science Quarterly, Vol. 16, No. 2, Jun., 1971, pp. 216-229. Johnson Graduate School of Management, Cornell University, D. J. Hickson, C. R. Hinings, C. A. Lee, R. E. Schneck, J. M. Pennings. Management theory seeking to enable organisations cope in uncertain environments is not new. Hickson in 1971 noted that organisations coped with uncertainty by adopting a 'prevention', 'forecasting' or 'absorption' strategy. Prevention attempts to reduce the emergence of uncertainty, forecasting is meant to anticipate change and absorption essentially amounts to damage limitation once uncertainty is present.

17 A balance must be found between two divergent impulses: for centralised cooperation and synergy on the one hand, and on the other for decentralised business unit leadership and ownership of specific regulatory change programmes.

18 A single view of regulatory risks can: create agreed interpretations of the meaning of regulation; identify regulatory overlaps and synergies between different regulations and parts of the organisation; and increase the level certainty/reduce uncertainty in regulation.

19 The three lines of defence model is typically used within European insurance as a way of organising risk governance and control frameworks – to which many (but by no means all) of the functions involved in regulatory change and compliance belong.

20 The portfolio approach is also essential when infrastructure changes with high costs and long lead-in times need solutions which address both known and emerging regulation.

21 Many insurers adopt a 'wait and see' approach when faced with regulatory uncertainty. This may be a valid and deliberate strategy, or it could be due to poor regulatory monitoring, or weak assessment and planning capabilities.

22 Scenario planning is not restricted to use with uncertain situations. It is a useful technique in planning for all types of certain and uncertain regulation. However scenario planning can be particularly useful in bringing structure to the way insurers input uncertain regulation into the wider strategic planning process.

23 Scenario planning processes typically include the following process: decide on key question to be answered; set time and scope of analysis; identify major stakeholders; map basic trends and driving forces; check for uncertainties; group any linked forces; reduce to two most important forces; assess to the outcomes of these forces; define scenarios.

24 For example, the proportion of permanent full time employees to total staff in the regulatory change and compliance teams.

25 Insurance Times, April 25th 2013. See also http://www.insurancetimes.co.uk/rq-to-redomicile-to-bermuda-over-solvency-ii/1402196.article.

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