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IAIS update: 2017 Global Seminar

Contents

International insurance regulators stay the course, but adjust the guardrails

OLD WINDSOR, UK—"Guardrails" was an oft-used word at the tenth Annual Global Seminar of the International Association of Insurance Supervisors (IAIS) Old Windsor, UK, this summer. Guardrails are a primary focus of the work of the IAIS, with the goal being to help keep the economy and, more specifically, the insurance sector from heading off the cliff of systemic risk.

Key IAIS initiatives devoted to the mitigation and reduction of systemic risk include the development of both a Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) and of International Capital Standards (ICS) for internationally active and systemically important insurers.

That work continued relatively on target, though with a few new factors that may grow in significance. One may be a changing political climate that includes Brexit and increased suspicion of international trade and trade agreements. Another may be a reevaluation of systemic risk and the most effective approach to managing it.

The IAIS announced plans for a public consultation on ComFrame—including ICS version 2.0—in mid-2018. The IAIS also announced that ICS version 1.0 had been approved for extended field testing. This was subsequently published on July 21. Attendees were reminded that the ComFrame initiative was broader than just the ICS. It includes areas such as enterprise risk management and governance. The Insurance Core Principles (ICPs) are being reviewed and updated to align with ComFrame.

IAIS speakers said they were encouraged that volunteers for ICS field testing continued to increase year over year. In 2017, close to 50 participants are taking part with new members joining from Europe and Asia. Field testing is allowing for good learning opportunities and feedback on a difficult project, according to one IAIS speaker who paraphrased the John F. Kennedy quote: "We are not doing this because it is easy, but because it is difficult."

The disagreement continued between some American stakeholders and certain other international stakeholders—both regulators and the regulated—over the structure of, if not the very need for ICS.

But the political backdrop was new: This was the first IAIS event held since the inauguration of President Trump, whose administration is commonly believed to be far more sympathetic to state regulators in the US and others opposed to the apparent imposition of international standards.

In her welcome speech as both chair of the IAIS Executive Committee (ExCo) and representative of the host Bank of England, Victoria Saporta noted the political concerns:

"International standard-setting organizations have been criticized recently by some organizations over transparency

and lack of stakeholder engagement," Saporta said. The ExCo chair said she thought the IAIS was ahead of the curve and of similar organizations, but could always do more and was always open to advice from stakeholders. Noting that attendance at this global seminar was up 20 percent over a year ago, Saporta said that she has always been a big fan of transparency, and had been involved throughout her career in working to increase transparency.

As if in answer to those who question the regulatory authority of international bodies such as IAIS, Saporta told the assemblage that the IAIS was a standard setter, and that it was the prerogative of the appropriate local authorities to implement or not implement the standards to which they had agreed by consensus at the IAIS.

She noted that the development of the ICS should focus on regulatory outcomes and that there may be more than one workable approach. A phrase used during the conference was "one language, many accents," perhaps in acknowledgment that a flexible approach to ICS is needed. The IAIS reiterated that it was committed to the timely delivery of ICS v.2.0.

Speaking for the last time to the IAIS Global Seminar as secretary general, Yoshi Kawai said international regulators had spent the first three days in intensive debate over core issues and planned to fill the next two days with communication and dialogue with stakeholders.

Kawai said market conduct was very important to regulators, and that they also intend to increase their focus on fintech. Later in the event, Kawai revealed that the IAIS ExCo had voted to dedicate resources to the rapidly expanding world of regulatory technology (regtech).

One other decision by the IAIS may have significant consequences. After devoting its resources to creating a regulatory framework focused on an entity-based approach to systemic risk management, the IAIS has now decided to create a work stream focusing on an activities-based approach.

One possible ramification may be that insurers who would not have fallen under scrutiny under an entity-based approach because of size or market serviced could potentially see heightened scrutiny because they participate in activities deemed possibly systemically risky.

Takeaways

- Work on capital standards will continue despite ongoing disagreement—especially from American stakeholders. Along with the continuing spread of the Solvency II regulatory approach and the adoption of IFRS 17, this may mean increased regulatory pressure on larger and international US insurers.
- A new emphasis on systemically risky activities opens the way for new standards to affect far more than the relatively few large companies currently targeted under either ComFrame or as global systemically important insurers (G-SIIs). This argues for continued, if not intensified, involvement by a wide range of US insurers. The number of US insurers and regulators attending IAIS meetings has steadily increased, and the involvement of various US industry trade groups has been noticeable.
- Market conduct continues to increase in importance as a regulatory focus. Like the National Association of Insurance Commissioners (NAIC), the IAIS has reiterated the centrality of consumer protection to its mission and stated its willingness to devote resources to the creation of high-level conduct of business principles.
- The importance of what the IAIS sees as "the digitalization of the insurance sector" is reflected in the dedication of organization resources to fintech and regtech. NAIC President and Wisconsin Commissioner, Ted Nickel, mentioned on one panel that NAIC had created a work stream devoted to fintech and regtech, and now so has the IAIS. This may mean a more intensive regulatory examination of the uses of fintech by insurers and associated entities, as well as an exploration by regulators of the use of regtech tools to increase the scope, speed, and validity of their own regulatory activities.

ComFrame consultation results released; stakeholder concerns aired

Attendees at the IAIS Global Seminar were given an update on the qualitative and quantitative standards surrounding ComFrame. The IAIS issued a comprehensive consultation on ComFrame-related material in March 2017, and released ICS version 1.0 for extended field testing in July.

Panel moderator, Elise Liebers, acting chair of the IAIS Financial Stability and Technical Committee, said that 39 stakeholders and 13 members had provided comments. Liebers said that ICP 12 resolution had received significant comments in particular.

Areas covered by the consultation included supervisor and supervisory measures, supervisory coordination and cooperation, governance, and resolution. Revised ICP 9 (supervisory review and reporting), revised ICP 10 (preventive measures, corrective measures, and sanctions), revised ICP 3 (information sharing and confidentiality requirements), revised ICP 25 (supervisory cooperation and coordination), ICP 5 (suitability of persons), ICP 7 (corporate governance), ICP 8 (risk management and internal controls), and revised ICP 12 (exit from the market and resolution) were the insurance core principles involved in the consultation.

Liebers said that in general, commenters saw the ComFrame revisions as more user-friendly, but said clarity still needed to be worked on and that there was not much feedback on a cost-benefit analysis. The integration of the revised ICPs into the ComFrame framework was seen as successful.

Ryan Workman, chair of the IAIS Supervisory Material Review Task Force, discussed the reaction to the revisions to ICPs 9 and 10 and the ComFrame introduction. Workman said the ICPs had been revised for clarity, consistency, and flow, and had been linked to ComFrame if needed. The ComFrame introduction had been revised to use the structure and format of the ICP introductions, while adding overarching concepts in addition to the ICPs.

Workman said comments had been received on the lack of clarity on the interaction between ComFrame and the ICPs. The IAIS also received suggestions on additional overarching concepts, including materiality, confidentiality, and data protection. Confidentiality material in ICP 2 will be out for consultation shortly.

Some commenters also had questions about the definition of, and criteria for, designation as an internationally active insurance group (IAIG), but Workman said this was not within the scope of this consultation.

Regarding ICPs 9 and 10, concerns were expressed about the expectations of external auditors, as well as the stability of reporting requirements.

Tom Crossland, chair of the IAIS Insurance Groups Working Group, reviewed the ComFrame content in ICPs 9 and 10, as well as feedback on ICPs 3 and 5. Crossland said new, added material included more structure around the IAIG supervisory process—with group-wide risk assessments at least annually, a recovery plan, and the ability to hold the head of an IAIG to relevant standards even if it's not an insurance company.

Comments received on ICP 9 concerned confidentiality, as well as consent for on-site inspections at the level of the head of an IAIG without IAIG permission—a proposed increase in regulators' authority. With regard to ICP 10, commenters suggested that any direct powers over the head of an IAIG should be limited to guidance, and that clarification was needed on a group-wide supervisor's power over an IAIG head when that organization was not in its jurisdiction.

Crossland said that in ICPs 3 and 25, with regard to ComFrame, the clarity and consistency of the language had been improved and there had been significant streamlining. In addition, the concept of a legitimate interest and valid supervisory purpose had been explained. ComFrame in ICP 25 maintained the requirement for the establishment of supervisory colleges for IAIGs, and introduced a specific requirement for the establishment of a crisis management group.

Comments received on the changes were mainly positive, Crossland said. One common desire was to have ICP confidentiality requirements attached to all information exchanges. He explained that the intention of ICP 25 was not for the supervisory college to be a decision-making body or to interfere with national powers.

Urs Halbeisen, vice chair of the IAIS Financial Stability and Technical Committee and chair of the IAIS Resolution Working Group,

discussed changes to ICP 12. Halbeisen said it had been revised because the current ICP 12 had only two standards and applied only to legal entities. The revised standard takes into account international developments, including the Financial Stability Board's (FSB) Key Attributes, and now applies both on a legal entity and a group-wide basis.

ICP 12 focuses on exit from the market, voluntary or not, and on resolution. Resolution is defined as the notion that covers portfolio transfer, runoff, restructuring, and liquidation. Comments received included questions on voluntary field testing, as well as on proportionality—how measures should apply to various levels of companies, e.g., systemically important financial institutions (SIFI), G-SIIs, IAIGs, and small IAIGs.

Discussing the ComFrame governance material integrated with ICPs 5, 7, and 8, Annick Teubner, chair of the IAIS Governance Working Group, noted that most comments were received on the ICPs, not on ComFrame. Comments included concerns that ComFrame was designed for a centralized governing structure. Teubner said ComFrame was not meant to favor any specific approach. There was a similar issue with types of insurers, such as a stock or mutual company, with some commenters believing ComFrame favored a particular structure.

On ICS 1.0, Paolo Cadoni, chair of the IAIS Capital, Solvency, and Field Testing Working Group, began by noting the growth in field testing volunteers. He said they now numbered up to more than 50. He called it a learning experience on both sides, with one lesson being that financial theories may not work effectively in different markets. Because of this, the identification of a global solution was difficult. Cadoni said the IAIS was still exploring policy issues for capital resources.

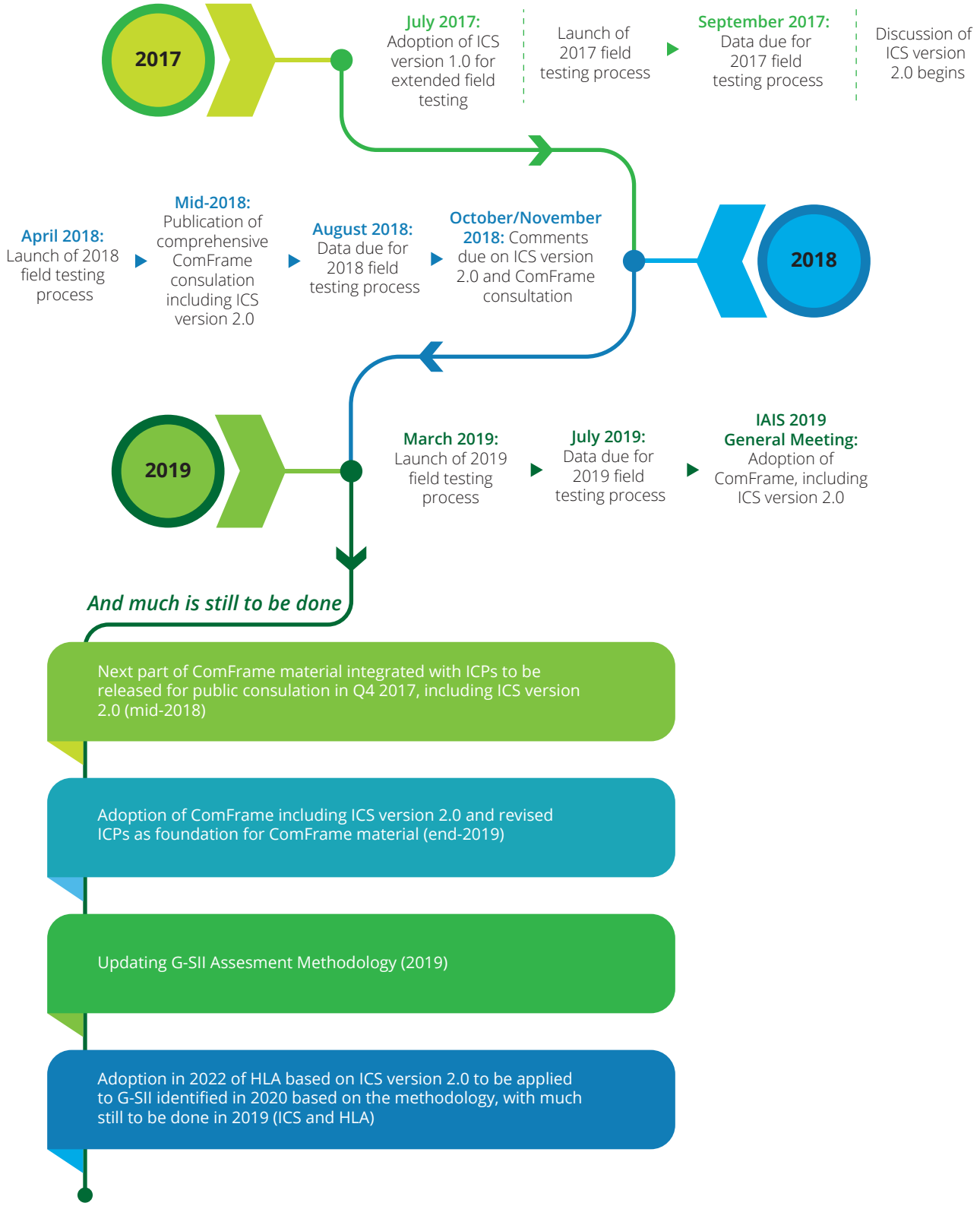
ICS 1.0 for extended field testing is less technical and more compact than the 2017 field testing package, he said. The technical and policy choices for both the extended field testing and the 2017 field testing package, as well as the options explored, are the same. However, the field testing package is the data request intended for the volunteer groups, with far too much detail for the wider stakeholder community.

The extended field testing has 124 pages versus 339 pages of technical specifications in the field-testing package. Both will cover all the components of the ICS including the two evaluation approaches, i.e., the Market Adjusted Valuation (MAV) and Generally Accepted Accounting Principles (GAAP) with Adjustments (GAAP Plus).

ICS capital resources, ICS capital requirements based on the standard method, and the scope of the group and perimeter of the calculation of the ICS are included in both.

Cadoni said field testing would now move to an 11-month cycle. That cycle had been reduced to coincide with the adoption timetable. He saved one of the more significant news items for last: A new ExCo task force will work to resolve issues that cannot be decided technically.

Figure 1. Next steps in ComFrame initiative



Source: International Association of Insurance Supervisors

Panelists discuss the path forward for ComFrame

Own capital model or common capital standard? Qualitative or quantitative metrics? Aspirational or implementable? Members of an IAIS panel on "ComFrame: Looking towards adoption" had a lively discussion of the challenges involved in finalizing ComFrame, its validity, and the changes it may bring.

Asked by panel and IAIS ExCo chair, Victoria Saporta, about the relative usefulness of qualitative and quantitative metrics, the managing director for regulatory policy of a large US insurer said he thought the ICS was useful for comparability and as a communication tool. It added coherence and helped in the understanding and management of complexity. But it might not be enough.

"We clearly can't rely on just a quantitative metric," he said. He added that it was important to have qualitative metrics. As an example, he cited liability discounting as essentially quantitative, but requiring internal assumptions that should be valid and have guardrails—in essence a qualitative assessment.

Another panelist was the chief of corporate planning for a large Japanese life insurer. That panelist said he supported ICS and ComFrame, but having said that, "You cannot tell the whole business story of a company doing business globally with a set of numbers." ICS should be used as a communication tool between regulators and those supervised, he said, adding that supervisory colleges are more useful and important than ever.

The US industry panelist said that real innovation was needed for the ongoing success of this process. "We need to look beyond 2019 for evolution and an evolutionary implementation," he said. Asked to define success, he said that if the result was increasing confidence at the entity level in jurisdictional supervisors about group supervision, it would be a positive. He called on regulators—who have been focused on macro prudential supervision to address systemic risk—to take the opportunity to look at micro prudential tools and how they could help manage systemic risk.

The director of external reporting at a large UK insurer said the challenge was to achieve an ICS that did three things:

1. It must be global (valuation and pro-cyclicality are concerns);
2. It must reflect the businesses and entities it sought to cover; and
3. It must be implementable.

He said there needed to be convergence between MAV and GAAP Plus in order to minimize noise. The director added that comparable outcomes where each group is assessing its own challenges and vulnerabilities were more difficult from a supervisory level, but more useful.

Connecticut Insurance Commissioner Katharine Wade noted that she had participated in numerous supervisory colleges. "We're all getting better," she said, with companies getting better at communicating and regulators getting better at understanding. Wade said regulators need to do a better job and challenge themselves to maintain flexibility.

Frank Grund, chief executive director of Insurance and Pension Funds Supervision at German regulator, BaFin, said there was a need for the ICS as a common language, but not necessarily as a legal, implemented framework.

Saporta said that ICS was the quantitative element, while the rest of ComFrame was qualitative. She spoke of the need to enable a common language for the Own Risk and Solvency Assessment (ORSA). Rebutting suggestions that the IAIS was overly focused on the ICS, Saporta said that resources were now being devoted to the ICS because that project was more difficult at this time.

She also spoke of guardrails, adding that they needed the quantitative standards (ICS) to be able to revise qualitative standards. Addressing the idea that companies should be able to use their own models instead, she said that the risk increased and there was more difficulty supervising under an own model concept because it created a double incentive to "risk up." She cited incentives to chase higher returns and effects on discounting.

Activities-based approach to systemic risk management is coming

As the IAIS continues its work on an entity-specific approach to systemic risk, the organization is also moving to a more holistic framework that incorporates an activities-based approach.

Elise Liebers, acting chair of the IAIS Financial Stability and Technical Committee, told the meeting that the activities-based approach is one of the most high-profile undertakings of the IAIS this year along with ICS. The charge of work stream one of the new IAIS task force will be "further developing the assessment of systemic risk in the insurance sector taking an activities-based approach."

Liebers also reviewed the work to date on the entity-specific approach. She said work was needed on the use of relative rankings, with the organization looking more to the use of reference values. The use of relative rankings has long been a concern of some industry stakeholders who have argued that systemic risk should be assessed on a set metric, not a sliding scale.

Work is also needed concerning insurers with bank or bank-like activities, she said, with supervisors wanting to make sure the results are consistent across sectors. On the liquidation channel, they were seeking to improve measures of liability, liquidity, and risk. The next round of revisions in the G-SII cycle will be in 2019.

Alberto Corinti, chair of the IAIS Systemic Risk Assessment Task Force, said that an activities-based approach could involve some policy measures. He said micro prudential policy measures could not only reduce the risk to companies, but to the system. The work of the task force, he said, is to include "the identification of policy measures (quantitative and qualitative standards) to address systemically risky activity already existing within the current standard-setting work, and if needed, proposals for development of policy measures above and over such current standard-setting work."

Stephen Seitz, vice chair of the IAIS Financial Stability and Technical Committee, spoke of the work to be done by work stream two. Work stream two is charged with "improving cross-sectoral consistency in systemic risk assessment, with input from the BCBS (Basel Committee on Banking Supervision)."

Seitz said the BCBS and the IAIS had been working together looking at the insurance subsidiaries of banking groups and banking subsidiaries of insurance groups. Any inconsistency in the G-SII or global systemically important bank (G-SIB) processes could lead to unintended consequences, he said.

Asked if the derivatives reform that followed the last fiscal crisis represented activities-based reform, Corinti said that it was a good example of activities-based reform but still too early in the IAIS context to evaluate.

"We are at the beginning of our own work," he said. "We are not ready yet to share a conclusion."

The projected timeline for this project is 2017 to 2019. Work on the development of a conceptual framework for an activities-based approach and on cross-sectoral consistency in systemic risk assessment is expected to be followed by a consultation on the initial findings in November. The G-SII assessment methodology is planned for review in 2018, with finalization of the revised systemic risk assessment framework expected in 2019.

ExCo discusses valuation, systemic risk management approaches, and more

Much is still up in the air about the ICS. That became clear during the ExCo dialogue session at the Global Seminar.

The ExCo dialogue session is possibly the centerpiece of the seminar and the exemplar of the IAIS outreach efforts to stakeholders. It is a forum for IAIS members and stakeholders to discuss priorities and current thinking on issues of common interest. ComFrame and the ICS are among the most significant undertakings of the IAIS.

Discussing the move from ICS 1.0 to 2.0—details to be decided by 2019—ExCo Chair, Victoria Saporta, said there may or may not be two valuation approaches: MAV and GAAP Plus. Saporta said the IAIS is moving to one valuation approach, but there are no guarantees.

Acting Chair of the Financial Stability and Technical Committee, Elise Liebers, agreed a single approach was a goal the IAIS was trying to achieve. For now, the organization at least aspired to having one GAAP Plus approach and one MAV approach in ICS 2.0. Responding to a question from Michelle Rogers of the National Association of Mutual Insurance Companies (NAMIC), Liebers revealed the IAIS was testing some high-quality portfolios with both valuation approaches in an attempt to narrow the gap between them.

Frank Grund, chief executive director of Insurance and Pension Fund Supervision at Germany's BaFin, discussed the use of internal models. He called the issue complex, and said the current plan envisioned exploring internal models as part of ICS 2.0.

While some regulators had expressed concern about the use of internal models, Grund said that speaking from his regulatory perspective as a German regulator, the companies he supervised that used internal models were the best as they had the most communication. Personally, he said, he hoped for a clear path to the use of internal models in ICS.

Liebers noted that internal models presented some challenges, in particular with their use across jurisdictions.

NAIC President, Ted Nickel, of Wisconsin expressed the continuing skepticism of some US stakeholders. Nickel told the assembled group that regulators needed to "get it together" and "get uniformity in something as simple as ORSA" before they try to implement ICS across jurisdictions.

Asked whether the newly announced activity-based approach was complementary or a replacement for the entity-based approach to systemic risk management, an ExCo member replied that either was possible, and at this point there was no prejudgment. The committee declined to share a white paper one panelist said was completed last year, which led to the creation of the task force exploring the activity-based approach. Saporta told the audience the IAIS and FSB had decided to develop the activity-based approach as "a complementary approach for the time being... This is the current position."

Incoming IAIS secretary general and current chair of its Implementation Committee, Jonathan Dixon, addressed the issue of IAIS efforts in emerging markets, especially as related to macro prudential supervision. Dixon said ICS was not designed for local groups, but that ComFrame was aimed at increasing the efficiency of group supervision, including host supervision. That could help increase the capabilities of supervisors in emerging markets

"The importance of involving the local host supervisor in developing ComFrame is definitely taken into account," Dixon said. NAIC consumer representative Birny Birnbaum suggested the IAIS should also be helping emerging economies avoid credit-linked insurance concerns.

Highlights:

- Valuation approaches still being decided for ICS
- Regulators split on the use of internal models
- The activity-based approach to systemic risk management is complementary to the entity-based approach—for now
- Fintech and related market conduct near the top of the list of regulatory concerns

IFRS 17 moves toward implementation

IFRS 17 is here and it will make the world a better place.

Given that the US is among the countries that have not adopted the new International Financial Reporting Standard (IFRS) on insurance contracts, this may be a bit of a stretch, but two members of the International Accounting Standards Board (IASB) optimistically shared the goals and status of IFRS 17 with the IAIS.

Work on IFRS 17 first started in 1997, with the final standard issued 20 years later in May 2017. Darrell Scott of the IASB said that 84 percent of jurisdictions—126 of 150—require IFRS standards for all or publicly accountable insurance companies. Other countries such as China have not formally adopted IFRS, but have converged their standards with IFRS, he said.

While the US Financial Accounting Standards Board (FASB) is not implementing IFRS, Scott said that the work the FASB is doing on targeted improvements to US GAAP comes close to the IFRS.

IFRS 17 will be effective on January 1, 2021, although companies may begin to use it sooner subject to certain conditions. It replaces IFRS 4. According to the IASB, "IFRS 17 Insurance Contracts establishes the principles for the recognition, measurement, presentation, and disclosure of insurance contracts within the scope of the standard. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance, and cash flows."

According to Scott, the goal of IFRS 17 was to provide one standard to improve comparability both among insurers and across industries, and to improve financial information so it would be more up-to-date and include better profitability measurements. IFRS defines insurance by contract event, which means there is a risk transfer in return for a promised payment on occurrence of the covered event.

"Profitability reporting for insurance entities will now be consistent across all jurisdictions," said Scott. He said the new accounting framework was designed to provide useful information to investors and analysts including information on how a company earned its profits. He said it should be considered a measurement of the value of a company at a point in time and an assessment of its prospects over time.

Izabela Ruta of the IASB said IFRS 17 enhanced the simplicity of the balance sheet presentation. The new statement of financial performance is a "more revolutionary change," she said. All products would be treated similarly to provide comparability, and insurance service results would be shown reflecting underwriting profit.

"We will have quite a rich information package with disclosures," she said. These would include the quantitative disclosures, as well as disclosures on underlying judgments used in preparation and associated risks. The balance sheet reconciliation would provide information on profitability.

The IASB expects implementation to begin now and include a period of questions and guidance until early 2019. Final implementation should begin in late 2019 to early 2020 with the effective date of 2021. During the final implementation phase, the IASB expects to provide minimal additional guidance.

A representative of a large multinational insurer with a significant US presence said that IFRS 17 did not seem to be written for the US market, and he expected vast differences in how companies applied what was written.

Figure 2. IFRS 17 at a glance

Insurance contracts combine features of both a financial instrument and a service contract. In addition, many insurance contracts generate cash flows with substantial variability over a long period. To provide useful information about these features, IFRS 17:

Requires an entity to make an accounting policy choice of whether to recognize all insurance finance income or expenses in profit or loss, or to recognize some of that income or expenses in other comprehensive income.

Combines current measurement of the future cash flows with the recognition of profit over the period that services are provided under the contract.

Presents insurance service results (including presentation of insurance revenue) separately from insurance finance income or expenses.

Supporting materials for IFRS 17

The key principles in IFRS 17 are that an entity:

- Identifies as insurance contracts those contracts under which the entity accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
- Separates specified embedded derivatives, distinct investment components, and distinct performance obligations from the insurance contracts.
- Divides the contracts into groups that it will recognize and measure.
- Recognizes and measures groups of insurance contracts at:
  - i. a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information—plus (if this value is a liability) or minus (if this value is an asset); and
  - ii. an amount representing the unearned profit in the group of contracts (the contractual service margin).
- Recognizes the profit from a group of insurance contracts over the period the entity provides insurance coverage, and as the entity is released from risk. If a group of contracts is or becomes loss-making, an entity recognizes the loss immediately.
- Separately presents insurance revenue (that excludes the receipt of any investment component), insurance service expenses (that excludes the repayment of any investment components), and insurance finance income or expenses.
- Discloses information to enable users of financial statements to assess the effect that contracts within the scope of IFRS 17 have on the financial position, financial performance, and cash flows of an entity.

IFRS 17 includes an optional simplified measurement approach, or premium allocation approach, for simpler insurance contracts.

Source: IFRS Foundation

"Bad boys, bad boys (in insurance distribution)—whatcha gonna do?"

As concerns are expressed in numerous jurisdictions about good conduct in insurance distribution, what should regulators do next? Panelists debated that question at the Global Seminar.

Nic De Maesschalck, director of the World Federation of Insurance Intermediaries, said he thought it was time for a regulatory pause and a time for legal stability. He told his fellow panelists and listeners he thought it was time to work together to send a message to consumers and investors letting them know they can have confidence in the market.

Maggie Craig, head of Insurance and Pension Policy/Strategy and Competition Division of the Financial Conduct Authority (FCA) of the United Kingdom cited the new insurance distribution directive distributed by the FCA as one example of regulation designed to promote good conduct and improve consumer confidence. "It will make a difference," she said.

Christian Mikula of the Australian Securities and Investment Commission discussed one challenge facing Australian regulators: auto credit insurance. Describing his experience with the product, he said loss ratios were consistently less than ten cents on the dollar and sometimes as low as two to three cents. Commissions to auto dealers were as high as 79 percent, and typically about 40 to 50 percent. One product regulators studied had a premium that would be more than the loan extended.

The risks of bad outcomes were borne by consumers in this model, he said. After various investigations, some insurers have exited the market given the reputational risk, but there needed to be legal change to allow for regulatory intervention.

NAIC consumer representative and panelist, Birny Birnbaum, called this one of "a number of smaller insurance markets in which the consumer is captive to the intermediary." He said this represented "reverse competition" when the customer of the insurer is not the consumer but the distributor or gatekeeper.

Birnbaum expressed the concern that this system has spread beyond niche products, and the new gatekeepers are big data algorithms being used in marketing, pricing, and claim settlement.

He said regulators should look at factors such as the cancellation rate and the amount of coverage in evaluating product and product distribution.

The FCA's Craig noted that in the UK ancillary intermediaries such as travel agents and auto dealers are regulated. She supported the use of so-called regulatory sandboxes, saying that they did not mean less regulation or allowing dangerous ideas, but supporting innovation that could end up being a positive for consumers.

Digitalization raises consumer concerns

The IAIS recently released a report entitled "Fintech developments in the insurance industry." The organization noted that the "digitalization of the insurance sector is a policy area warranting further supervisory attention." A panel at the IAIS Global Seminar discussed the effects of innovations on insurance consumers, seeking to explore both benefits and risks.

Stefan Claus, technical head of the General Insurance Division, the Prudential Regulatory Authority (PRA), Bank of England, said he thought there were too many unknowns to yet form a view on fintech. He said it was too early to form an opinion on blockchain for example, saying much depended on unanswered questions such as whether the sharing economy will continue to grow.

He saw a variety of options for the future of the insurance industry, from cooperative projects with other entities at one end, to insurers becoming generic providers on the other.

Claus said that the Bank of England expected competition to decrease because of technological innovation. Technology may decrease risk, but that may lead to less competition, he said. That could mean fewer consumer choices, concerns about the conduct of business, and less transparency in pricing.

A representative of a Dutch insurance group had a more positive take. She said technology shifted the proposition to a personal and relevant level. At her group, it had moved thinking to start from consumer engagement instead of the tariff structure.

NAIC consumer representative Peter Kochenburger, deputy director of the Insurance Law Center and associate clinical professor of law at the University of Connecticut School of Law, was less sanguine.

Data advances, he said, "also come with serious concerns about data ownership and security, privacy, and insurance access and affordability, and how to set boundaries on their appropriate use. . . . These decisions should be made by our political and regulatory institutions, and not defaulted to the private sector."

While regulators have often cited the power of disclosure in consumer protection, Kochenburger said that disclosure will likely become increasingly ineffective as a consumer protection tool. He cited the example of a consumer tech service provider. The company provided disclosure allowing consumers to choose to accept—and thus sell their soul to the company in perpetuity—or decline and actually get a cash payment from the company, while incidentally retaining ownership of their soul.

As technology use evolves, Kochenburger said, so will consumer protection issues. While artificial intelligence programs may be used to look for evidence of fraud and thus pay claims almost instantly where no fraud was discovered, Kochenburger asked how policyholders would know if a claim had been tagged as fraudulent and why. "Will disclosure alone protect consumers? Absolutely not!" Kochenburger said. "Transparency in the digital age becomes even more difficult."

Li Tang, vice chair of the IAIS Implementation Committee, raised another consumer protection question: "As products become ever more targeted, could products tailor-made by big data reduce comparability?"

A consultant on the panel noted that the best result of insurance industry digitalization would be more touchpoints and increased digital interaction with consumers.

Regulators seek market development

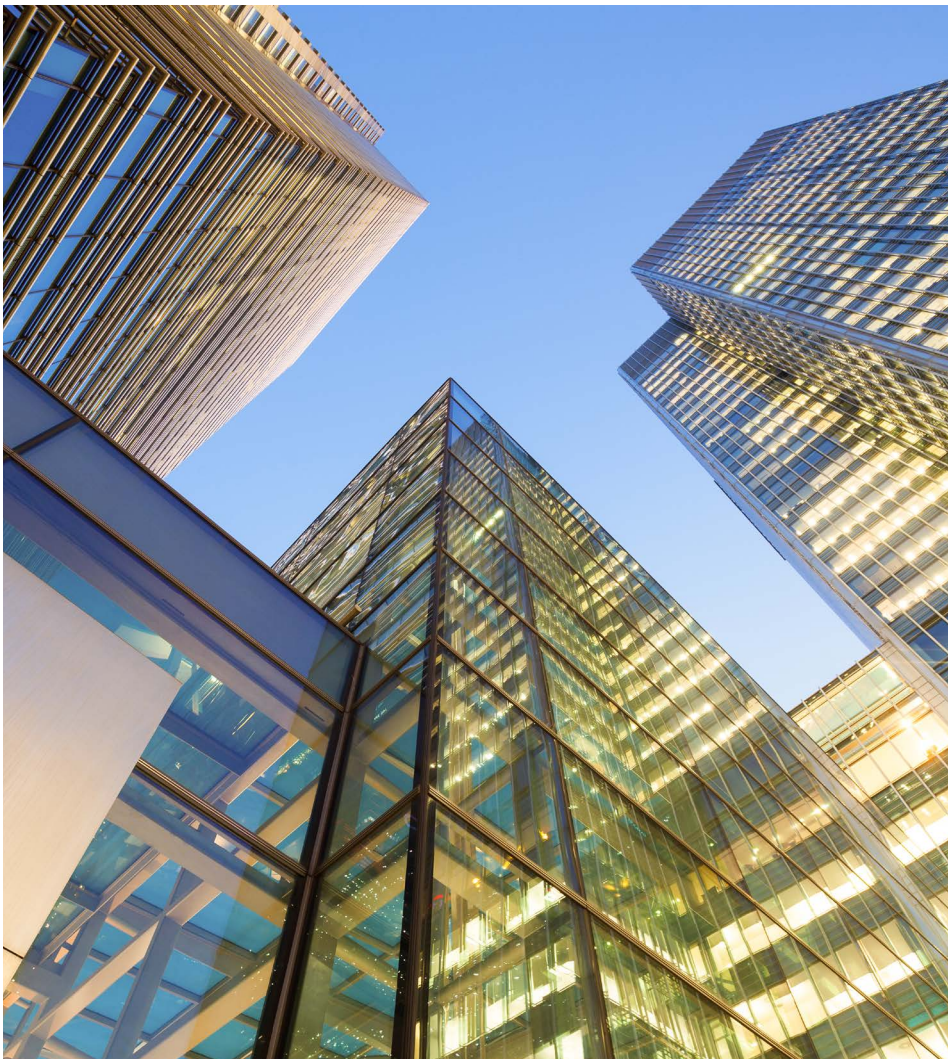
Hannah Grant, head of the secretariat, Access to Insurance Initiative (A2ii), told a meeting on the Implementation of International Standards and Market Development that increasingly in emerging economies, market development is being included in regulatory mandates.

Methods through which regulators help market development vary from collecting data identifying underserved markets and providing the data to industry on the low end, to mandating the provision of certain products to certain markets (as is done in India) on the high end.

This is based on the idea that serving the underserved will help the market develop, Grant said. She added that to be successful, regulation should conform to the maturity of the market.

What's next

- August 6–9: NAIC Summer 2017 National Meeting; Philadelphia, PA
- October 30–November 3: IAIS General Meeting and Annual Conference; Kuala Lumpur, Malaysia
- November 16–19: NCOIL Annual Meeting; Phoenix, AZ



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