2022 insurance regulatory outlook
Successfully navigating a complex regulatory environment
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Introduction

Several high-priority topics lead the regulatory agenda, and insurers should continue to be cognizant that work on capital standards remains underway, with the anticipation that additional progress will be made during the coming years. Individually, many insurers are forging ahead to better consider, adopt, and implement some of the more critical aspects of that agenda, including digital transformation, data protection, and climate risk. While market conduct and consumer compliance are long-standing areas of focus, the year ahead will place the onus on insurers to adhere to ever-emerging regulatory risks and their associated requirements that vary by state and federal regulatory authority. This outlook provides insight into the regulatory landscape for insurers, outlining significant developments from the prior year as well as topics that insurers should follow closely.

The expanding regulatory perimeter

Across all sectors, we expect to see continued extension of the regulatory perimeter in 2022. While 2021 served as a year for the Biden administration to settle into governing, 2022 will be an opportunity to fill remaining key vacancies, which will allow the agencies to better fulfill their regulatory missions. There are frontier topics like climate finance and digital assets that are top of mind for many, but regulatory expansion is not limited to these areas. Foundational regulations are being tested not only by new technologies but also by new business models. As industries evolve and the lines between them blur, regulators increasingly feel that their entity-based frameworks are not sufficient to address emerging risks. They have even gone as far as enlisting Congress to bolster their authority in rapidly evolving areas.\(^1\)

To the extent possible, they are also shifting their focus to activities and testing the limits of their authority. Horizontal integration and new business models have created an opening for financial regulators to wield some authority in industries that were not traditionally in their purview (namely, tech). Nevertheless, the agencies wish to address coming challenges proactively rather than reactively and as such, we expect them to move the needle substantially in 2022 in the areas of digital assets, ESG investing and cybersecurity, among others. Despite the activities focus, certain firms may face a barrage of challenges ranging from agency rulemaking and enforcement, to renewed enthusiasm for antitrust pursuits, to possible legislation.

In the area of climate policy, the specter of climate stress tests and scenario analysis looms large for financial institutions. However, ESG disclosure standards, which the SEC continues to promise, have the potential to impact every public company regardless of industry. Although it is a volatile and even more arduous process than agency rulemaking, legislation remains a wild card that could accelerate the current trajectory.

Firms should expect to devote more attention and more resources to regulatory changes in 2022 and beyond. Attempts by US regulators to “catch up” with their counterparts in Europe and elsewhere present a challenge not only to firms but the regulatory agencies as well. Thus, the present moment is ideal for engagement with policymakers; rather than deny the conversation, firms should seek to inform it.
The development of insurance group capital

As regulators turn their attention to emerging priorities such as climate risk, cybersecurity, and the global pandemic, where does this leave the previously high-priority area of insurance group capital?

At the international level, development of the Insurance Capital Standard (ICS) continues. The baseline version of the ICS (known as ICS version 2.0) was agreed to in Abu Dhabi in November 2019, following six years of field testing. ICS version 2.0 entered a five-year performance monitoring period in 2020, with final modifications expected to be consulted upon in 2025. Once implemented, the ICS will be a core component of the Common Framework (ComFrame) for the supervision of Internationally Active Insurance Groups (IAIGs) and will deliver a groupwide prescribed capital requirement (PCR). Also, it will provide a common way for supervisors of IAIGs to compare group solvency.

At the time of the agreement on ICS version 2.0, the United States and other interested jurisdictions had been developing their own Aggregation Method (AM) group capital calculation. In Abu Dhabi, it was agreed that—during the ICS 2.0 five-year monitoring period—the AM would be compared to the ICS to determine if it offers equivalent outcomes. Since then, the International Association of Insurance Supervisors (IAIS) has been collecting data on the AM while working to define the comparability criteria.

Work on the AM by the National Association of Insurance Commissioners (NAIC) and interested jurisdictions has been influenced by US development of the Group Capital Calculation (GCC). In the wake of the financial crisis, it was recognized that there was no consistent way to assess solvency for an insurance group and its non-regulated affiliate companies. The lack of a group capital framework in the United States was also highlighted by the International Monetary Fund (IMF) Financial Sector Assessment Program in 2014. Since 2015, through the efforts of both the ComFrame Development and Analysis working group and the GCC working group, the NAIC and state regulators have been developing a way to enable the holistic and transparent assessment of an insurance group’s capital and overall financial condition. The GCC could also be used as a baseline for group capital assessment in the Own Risk and Solvency Assessment (ORSA).

The GCC underwent its own development period of iteration and field testing from 2015 to 2020. At the NAIC Fall National meeting in 2020, the states adopted NAIC Model Law (#440) and Model Regulation (#450), allowing full implementation of the GCC as a capital calculation and annual filing. The laws defined which insurance companies would be captured by the filing, and the definition is broader than that of the ComFrame where ICS version 2.0 defines an IAIG. The GCC is now subject to a period of trial implementation and model law adoption by the states. This work has been conducted in consultation with the Federal Reserve Board (the Fed), which has been developing its own Building Block Approach (BBA) for insurance group capital. The Fed has supervisory oversight of insurance groups that control depository institutions.

Each of these methodologies is detailed and prescriptive in its own right, taking a detailed view of important items such as: What is allowable or eligible capital? How is the value of insurance liabilities calculated? And what charges for risk should be held? Also, differences continue to be reviewed, such as how the ICS will be implemented as a PCR, and how the AM relates to the GCC.

Although a number of hot topics such as climate change, the pandemic, and cybersecurity are now dominating an already crowded regulatory agenda, companies should not lose sight of the new group capital standards and calculations. Work to assess performance, demonstrate comparable equivalency, and finalize the filings in this area continues—both internationally and domestically.
Regulatory convergence in life & annuity insurance sales practices and conduct risk

As insurers seek to grow sales of life and annuity products, particularly through third-party entities such as independent marketing organizations, they also face increased state and federal regulations as well as examination and enforcement risks.

The sets of regulations across the SEC, Financial Industry Regulatory Authority (FINRA) state departments of insurance, and Department of Labor (DOL) are increasingly converging on expected consumer conduct standards and compliance obligations (albeit with certain statutory differences for product and producer types). Importantly, insurers are expected to operationalize the oversight of sales practices of captive and independent sales forces.

At the state insurance level, the state adoption rate of the revised NAIC Suitability in Annuity Transactions Model Regulation reached 18 states in 2021, with six more states proposing and planning similar legislation. In principle, these regulations provide increased alignment with federal securities regulation under SEC Regulation Best Interest, which became effective in June 2020.

Following two waves of SEC exams (an initial “good faith effort” evaluation by firms to comply with the requirements of Reg BI, followed by a second phase to examine Reg BI compliance), it is expected that SEC and FINRA exams in 2022 will continue to focus on Reg BI through their normal exam protocols.

The end of the DOL’s Temporary Enforcement Policy for prohibited transactions rules (expired January 31, 2022) will subject investment advice fiduciaries to the requirements and enforcement under PTE 2020-02. These cover compliance regarding IRA rollovers, impartial conduct standards, and fiduciary acknowledgment requirement; specific documentation and disclosure requirements for IRAs will be enforced beginning June 30, 2022. IRA annuity policies and annuities in IRA accounts are subject to DOL enforcement.
As the mosaic of regulations affecting different aspects of insurance sales and conduct standards becomes more complete, some of the implications of these changes on insurers in 2022 include:

1. **De facto, insurers are operating in a “best interest” world.** With their representatives and agents expected to render advice in a way that puts the investor’s interest ahead of the interests of the financial institution and professional.

2. **More state regulations are extending the standards to traditional annuities** (note that NY Reg 187 has also applied best interest standards to life products in February 2020).

3. **Insurers may contract with intermediaries to perform compliance and oversight under the NAIC Model Act and DOL Rule, but will need to provide additional insurer supervision** to ensure that the mechanisms are sufficient to provide appropriate safeguards over sales practices and consumer conduct.

4. **The appropriate identification, disclosure and mitigation of conflicts** through the sales, supervisory and compliance process remain paramount across the regulatory landscape.

Following years of rule formation across multiple regulators, insurers should now be positioned with a regulatory playbook to implement effective programs to manage regulatory compliance obligations and expected examinations and potential enforcement risks.
Exploring the intersections of digital transformation, insurance, and regulation

The pandemic threw gasoline on the burning platform of digital transformation. Agents, employees, customers, and insurers all need to remain connected to conduct insurance-related activities.

Before the pandemic, some insurers had progressed toward interacting with stakeholders in a more automated and digital manner. Also, some were contemplating the use of digital technologies to improve their compliance programs. However, the digital journeys of many insurers were still nascent. Meanwhile, insurance regulators have been raising concerns about various aspects of digitization. Below are some key considerations that are arising at the intersection of digital transformation, insurance, and regulation.

Customer data and protection
To interact with customers digitally, insurers must source, hold, and use data—and not just any data, but data that is often extremely sensitive (such as banking and health data). Customer-facing portals are proliferating. Advanced modeling techniques are being deployed. And bad actors are sharpening their targets. These trends are raising regulators’ concerns about whether data use is fair and impartial, transparent and explainable, responsible and accountable, robust and reliable, safe and secure, and respectful of privacy. Some key issues include:

Ethical use of data: Is the data (and its related models) being used ethically and fairly? Is the data accurate, and are the models biased in any way that might be discriminatory?

Permission to use data: Has the necessary permission been granted to use the data? Does the permission expire and need to be refreshed? Many state regulations, including the California Consumer Privacy Act (CCPA), feature elements of permission and preference.

Data protection: Is the data properly classified and protected by the insurer and all affiliated parties? Both state and federal regulators, including the New York State Department of Financial Services (NYDFS) and the DOL, have issued data-related cybersecurity guidance that extends to third parties.

Privacy and cybersecurity
Strongly entwined with the use and safekeeping of sensitive customer data is the issue of cybersecurity. According to Fed Chairman Jerome Powell, cyberattacks are now the foremost risk to the global financial system, even more than the lending and Liquidity risks that led to the financial crisis. A report by the International Criminal Police Organization (INTERPOL) showed an alarming rate of cyberattacks during the pandemic with a significant target shift from individuals and small businesses to major corporations, governments, and critical infrastructure.

In the insurance space, a patchwork of state-based requirements creates a complex operating and compliance environment for firms. When it was created, the NYDFS Rule governing cybersecurity requirements was the most comprehensive in existence. Since its release, the standards set in Part 500 have only risen in importance since they have been largely incorporated into Federal Trade Commission (FTC) requirements. In addition, Model Law 668 developed by the NAIC has been adopted by 18 states. The law addresses how insurers and licensees protect personal information but does not provide much guidance as to what penalties regulators should impose for violations. The competing standards and state-based nature of much of the regulation creates a patchwork of requirements and risks for firms operating in the space. We expect this complex regulatory environment to persist in 2022 even if more states adopt Model Law 668.

Digitizing compliance
Compliance functions continue looking for new ways to use digital capabilities to improve how they manage compliance risk. These might include embedding models and tools in their operations to have all transactions tested and monitored against compliance rules; using data analytics to spot anomalies; and using advanced techniques to reduce false positives when conducting monitoring activities.
Emerging regulatory topics

**Digital assets**
The digital asset ecosystem—including innovations such as blockchain and cryptocurrency—has been growing exponentially, triggering regulatory concerns about customer protection, economic loss, and consumer education. Presently, there are two key touchpoints between the federal government and digital assets: (1) regulated financial instruments (e.g., securities, commodities) and (2) regulated entities (e.g., banks, exchanges). In 2022, legislation might expand the scope of regulated instruments and entities. However, it is even more likely that securities and banking regulators will use their existing authorities to place requirements on firms and clarify their expectations for the crypto space.

The fourth quarter of 2021 saw several weighty issuances that set the agenda for next year, including a report on stablecoins issued by the President’s Working Group (PWG), which includes the Treasury department. The PWG stablecoin report, issued in November 2021, lays out federal regulators’ collective vision for stablecoins. The report calls on Congress to enact legislation that creates a cohesive federal framework for stablecoin regulation, including imposing bank-like prudential standards on stablecoin issuers and any entities that facilitate stablecoin arrangements on existing and new payment rails leveraging distributed ledger technology. It also acknowledges that many stablecoins may in fact be securities (a frequent assertion of SEC Chair Gary Gensler) and recommends that federal regulators use existing authorities to control the space in lieu of congressional action. While legislative action is possible, other priorities may drive the congressional agenda, and gridlock is likely to take hold ahead of the midterm elections.

Beyond the dynamic regulatory and legislative environment, insurers have many issues to consider, including whether to accept digital assets as forms of payment or own these assets in their portfolios. Also, they must determine whether they have products with exposure such as theft or loss of such assets that may not have been priced. Alternatively, there may be a market to help provide protection of these assets. Finally, firms will need to determine the best way to implement any of these efforts.

**Environmental, social, and governance**
ESG considerations will remain a central focus for regulators in 2022. Although the past few years have seen regulators and standard-setters attempt to better understand this multidimensional issue, additional regulatory clarity is expected in 2022 and beyond. The associated challenges are not easy to navigate, and it will require a concerted response from all stakeholders to avoid unintended consequences.

Insurance industry regulators in the United States have been proactively reviewing existing supervisory tools that might be applicable. At the same time, they have been seeking to identify and understand what new tools, standards, and guidance might be needed. The US Department of the Treasury, through the Federal Insurance Office (FIO), announced its own response to President Biden’s May 2021 executive order on climate change. Specifically, on August 31, 2021, it issued a request for information to solicit public feedback on the FIO’s future work on climate-related financial risks in the insurance sector. The comment period closed November 15, 2021.

In 2022, we expect the FIO to continue assessing the impacts of climate change on the US insurance industry, with a focus on the sector’s financial stability (and on market vulnerabilities, especially for minorities and low-income communities). Although the FIO is not a regulator, the information it collects can help inform and shape regulatory policy development both domestically and internationally.
The NAIC, which supports the work of state insurance regulators, also has major programs underway. Its Climate and Resiliency (EX) Task Force has been charged with helping to coordinate this work, with the following proposed focus areas for 2022:

1. Evaluate climate risk disclosures (including a review of the NAIC’s own Climate Risk and Disclosure Survey)
2. Evaluate regulatory approaches for climate risk and resiliency (including items such as stress testing, scenario modeling, and solvency impacts)
3. Evaluate innovative climate risk and resiliency solutions (e.g., how technology can be applied and how product innovation might help)
4. Identify mitigation opportunities related to climate risk and resiliency
5. Consider the role of state insurance regulators in pre-disaster mitigation and resiliency
In parallel with the NAIC’s coordination efforts, a number of major insurance regulators are continuing with their own work, including the NYDFS. On November 15, 2021, the NYDFS issued its final guidance on managing the financial risks from climate change. This guidance requests that all New York insurers start building climate-related financial risk considerations into their governance, strategy, risk, and disclosure processes. NYDFS continues to push its supervisory work in this area, building on insurers’ expectations as well as its own analysis of the industry’s climate risk exposure. In 2022, NYDFS and other state regulators (both individually and as part of the wider NAIC coordination activities) will likely continue focusing on disclosures, managing climate risk, and other ESG issues.

The SEC has also been reviewing its position on climate-related risks with a focus on disclosure, with a view toward overhauling its past 2010 guidance for public companies. Investor focus on climate risk has increased significantly since 2010, and the SEC is seeking to increase transparency about companies’ climate risks through additional guidance on climate risk disclosures. This work partially aligns with what state insurance regulators are doing to review their own climate risk disclosures. Both the SEC and state insurance regulators (through the coordination activities of the NAIC) are looking at industry standards for disclosures, such as those produced through the work of the Financial Stability Board (FSB), which created the Task Force on Climate-related Financial Disclosures (TCFD). Following a consultation period in 2021, the SEC is expected to issue details of proposed changes early in 2022. In addition to increased disclosures, the SEC’s supervisory and enforcement activities will likely increase as well.

As regulators and key stakeholders across the insurance industry ramp up their ESG efforts, we expect further clarity on requirements (along with continued changes in supervisory focus and a move toward implementation). Firms would do well to get in front of these regulatory changes by considering the adequacy of their existing related programs.
Looking ahead

As covered in this outlook, insurers likely will enter 2022 with several focal points toward which they will need to deploy regulatory compliance and strategic resources. ESG and capital-related matters will continue to garner the attention of regulators as decisions are made to finalize rules and guidance. Participating in the upsurge in digital transformation, the increased usage of electronic data, and exploding market for digital currencies can create significant business value while simultaneously heightening inherent risk. While challenging, paying special attention to the intricacies of requirements that are not well aligned throughout state and federal agencies is essential as these differences potentially can be a source of regulatory scrutiny.
7. Brian Fung, “Cyberattacks are the number-one threat to the global financial system, Fed chair says,” CNN, April 12, 2021.
10. Ibid.
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