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Insurance regulation without boundaries: How to plan at home for change from abroad

Contents

International regulation will hit U.S. insurers hard

Why should insurance companies in the United States care what happens in Basel, Switzerland, home of the global offices for the International Association of Insurance Supervisors (IAIS)? After all, the U.S. insurance market is still easily the largest single market in the world. In 2012, total insurance premiums written in the U.S. added up to $1,840 billion, according to the National Association of Insurance Commissioners (NAIC).[1] In Europe, gross written premiums for the same year totaled $1,470 billion.[2]

Yet major changes lurk behind the scenes. Since the financial downturn, insurance regulation has become increasingly globalized and centralized. Even for insurers operating solely within the U.S., this means decisions on regulatory requirements – which for now are still being made primarily by state regulators – are increasingly being influenced by international factors.

For U.S. companies accustomed to operating under legal entity supervision, some of the most obvious changes are group supervision and new emphasis on both enterprise risk management (ERM) and corporate governance. And while new guidance manuals from the NAIC are highly visible, what is less clear is the increased cost of compliance versus the realizable benefits to an organization.

Part of the challenge is that regulation is now less an event than a structural trend. Regulatory uncertainty is still the watchword as insurers watch and wait for more clarity from regulators. However, it is already obvious that regulatory changes have imposed – and will continue to impose – substantially higher compliance costs for all U.S. insurance companies.

As U.S. insurers prepare for their first Own Risk and Solvency Assessment (ORSA) or Form F filings, or their first revision of their corporate governance guidelines, they may do well to do as regulators have, and look across the pond at Europe. There, regulatory changes similar to those now being imposed in the U.S. have already had a significant impact.

According to a recent Deloitte LLP study, the European insurance industry spent between $5.7 and $6.6 billion in 2012 to comply with the new regulations that have expected implementation dates between 2012 and 2015.[3] The study found that similar amounts had been spent in the preceding two years. For European insurers, these costs were equivalent to a 1.01 percentage point impact on Return on Equity (ROE), an amount that is surely sufficient to grab the C-Suite's attention.

Through interviews with senior insurance leaders in Europe, the study found that insurers in the region expect the cost of complying with the new regulations will continue at current elevated levels until at least 2015, and "many expect the new regulatory agenda to stretch far beyond this timeframe."[4]

In the U.S., where state insurance regulation has already been criticized by the Federal Insurance Office (FIO) as sometimes redundant, duplicative, and unnecessarily costly, one might well expect a duplication of the regulatory multiplier effect found in Europe. Results have not been encouraging. As the Deloitte LLP study noted, "[In Europe], higher regulatory volume in multiple jurisdictions is leading to 'execution-stretch' and sub-optimal implementation of regulatory changes."[5]

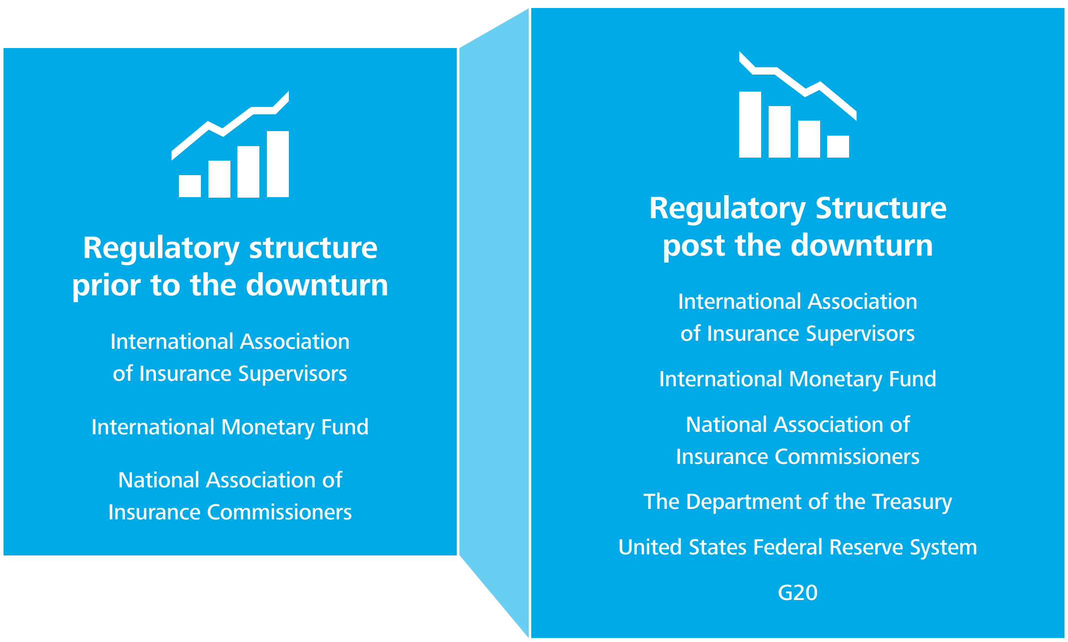
All of this new uncertainty from abroad is in addition to the many unknowns U.S. insurers already have on their radar. While domestic insurance companies operating primarily in this country might be tempted to focus their scarce resources solely on what is occurring within our regulatory borders, in the long run it would probably be a worthwhile investment to add capabilities and broaden compliance horizons to address the internationally driven challenges that will almost certainly affect all insurers.

With the FIO, the Board of Governors of the Federal Reserve Bank (Fed), the Office of Financial Research (OFR), and the Financial Stability Oversight Council (FSOC) among local additions to the alphabet soup of insurance regulators and regulatory influencers, insurers may be forgiven the slightest tinge of regulatory fatigue. However, the international language of the IAIS, the G20, the International Monetary

Fund (IMF), and others is gradually being written into the guidance manuals governing U.S. regulation. Global capital standards could, and probably will, become local capital standards in some form. Also, internationally influenced regulatory requirements related to ERM and direct holding company regulation are good examples of other developments now affecting – or poised to affect – insurance companies in the U.S.

The medium-term future could be defined by ongoing and possibly disruptive regulatory change driven by a wide range of stakeholders, some of whom are external to or not supportive of the U.S. market. Insurers might want to add capabilities to prepare for those potential changes, or even try to influence them, while there is still time.

Figure 1. Regulatory changes mean more international influence



Prior to the downturn, regulation of U.S. insurance companies was almost entirely done by a closed NAIC system, using U.S.-centric metrics, with relatively minor international influence through organizations such as the IAIS or IMF. Post the downturn, existing entities (such as the IAIS) and new ones (such as the G20) have moved to globalize and centralize insurance regulation, increasing international influence over U.S. regulation in the process.

Source: Deloitte 2014.

Structural changes for regulation and supervision

U.S. insurance regulation today is primarily the domain of the states. The current system has its roots back in 1851 – when the first state insurance commissioner was appointed in New Hampshire – and was formally codified by Congress in 1945 through the McCarran-Ferguson Act. However, this state-driven regulatory structure has faced increasing national and international pressure to change since the economic downturn. Also, while the taxonomy of U.S. insurance regulation seems straightforward, in reality it is often subject to the influence of organizations that are technically not regulators yet still hold tremendous sway.

For example, insurance regulators for each of the 50 states, five U.S. territories, and the District of Columbia all come together under the banner of the NAIC, a private nonprofit that they consider a standard-setting organization. Yet, despite guidance manuals and other evidence to the contrary, the NAIC is not a legally sanctioned regulator. The NAIC operates by passing a "model act," which reflects how the majority of state regulators believe an issue should be handled; however, each of the 50 state legislatures must individually pass the model act and the governor of each state must sign it before it becomes law.

Insurance legislators have their own national organization, the National Conference of Insurance Legislators (NCOIL). NCOIL and the NAIC have not always seen eye to eye on issues, but they are now working cooperatively and are looking to get more involved internationally – which is likely a reflection of the perceived threat to the current system of state regulation.

Also, following the financial crisis and passage of the Dodd-Frank Act, the Fed was given additional direct regulatory powers over select insurers. In addition to its regulatory authority over holding companies for banks and savings and loans, which may include insurers, the Fed also regulates insurers designated systemically important (a designation made by the FSOC).

The FIO is not a regulator, and neither is the OFR. Both are agencies within the Department of the Treasury. The FIO does represent the U.S. in international insurance organizations. And at the IAIS, the FIO shares membership with NAIC members and the Fed, among others.

Internationally, the IAIS is the standard setter for insurance. The IAIS is an organization similar to the NAIC in that it brings together insurance regulators from different jurisdictions. It is typically viewed as the top of the insurance regulation food chain, but, as was seen in the recent imposition of global capital standards, the IAIS must respect the wishes of the G20's Financial Stability Board (FSB) when it comes to matters of systemic importance.

The IAIS is responsible for creating the insurance core principles (ICPs), which are the overarching global insurance standards. In theory, these principles set a level playing field across the globe for insurance regulation and are expected to dictate insurance regulation in member countries. The IMF gets into the act through its Financial Sector Assessment Program (FSAP), established in 1999, a comprehensive and in-depth analysis of a country's financial sector. The IMF uses the ICPs as the basis for assessing insurance regulation in a given country.

International insurance regulations affect all domestic insurers, even those that do not operate overseas. International regulations, for the purposes of this paper, are those established by the IAIS, as well as regulations that apply extraterritorially, such as Solvency II.

While all U.S. insurers will eventually feel the effects of international regulations, certain types of companies will likely get an early introduction to the slings and arrows of changing global insurance regulations. Key characteristics of such companies include:

- Being seen as posing systemic risk
- Conducting insurance business in multiple jurisdictions
- Having a nature, scale, size, or complexity that attracts additional regulation/regulatory expectations.

Figure 2. International insurance regulation by the letters

Body	
G20	The premier forum for international cooperation on the most important issues of the global economic and financial agenda; consists of 20 leading industrial nations; established 1999; Finance Ministers and Central Bank of Governors
FSB	Financial Stability Board (FSB): FSB in Basel at the BIS; coordinates the work of financial authorities and international standard setting bodies
IAIS	International Association of Insurance Supervisors; established 1994; insurance regulators and supervisors of more than 200 jurisdictions in nearly 140 countries
NAIC	National Association of Insurance Commissioners (NAIC): NAIC is the standard setter in the U.S. and regulatory support organization
EIOPA	European Insurance and Occupational Pensions Authority (EIOPA): EIOPA integrated supervision; levels playing field to reflect increased integration of financial markets in the European Union
IMF	International Monetary Fund (IMF): IMF fosters global growth and economic stability; 188 member countries; specialized agency of the United Nations
Fed	Federal Reserve System (Fed): The Board of Governors role of the Fed includes supervising and regulating Systemically Important Financial Institutions (SIFIs) and banking institutions and maintaining stability of the financial system
FSOC	Financial Stability and Oversight Council (FSOC): FSOC is part of the U.S. Department of Treasury and established under Dodd-Frank; charged with ensuring the financial stability of the U.S.
FIO	Federal Insurance Office (FIO): FIO is part of the U.S. Department of Treasury; established under Dodd-Frank; charged with monitoring the insurance sector; also represents the U.S. on international matters

Source: Deloitte 2014.

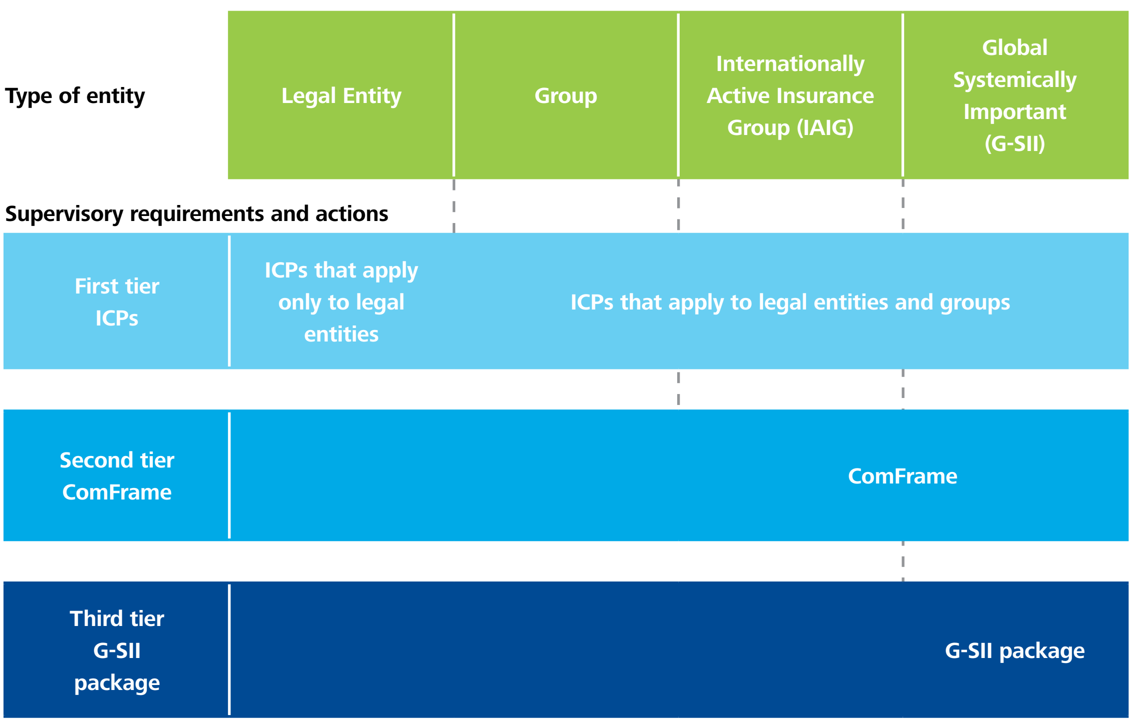
The international regulatory requirements and core developments that provide a framework for domestic regulation and supervision primarily emanate from three sources:

- The Insurance Core Principles (ICPs, last revised in 2012)
- ComFrame (currently being field-tested)
- The requirements for Globally Systemically Important Insurers (G-SIIs)

The direct impact of both ComFrame and G-SII regulation will likely be limited to a handful of large companies. However, the trickle-down effect could be enormous. As previously noted, the question of global capital requirements was initially limited to discussions on how to supervise larger companies, but the discussion of the scope of capital standards now seems to be steadily spreading to a point where it could become a *de facto* standard.

Figure 3. Architecture of IAIS international supervisory requirements

Insurers are subject to varying levels of regulation based on size and the number of locations in which they operate. The Insurance Core Principles apply to all insurers, with additional regulatory/supervisory requirements for groups, internationally active insurance groups, and global systemically important insurers.



Source: IAIS

What's more, what the IAIS is now calling the basic capital requirement (BCR) began life as the *backstop* capital requirement (BCR) for G-SIIs. If words have meaning, it is not difficult to see how moving from backstop to basic demonstrates the trend of moving capital requirements from limited cases to universal applicability. At a recent IAIS meeting, one rating agency representative even suggested a meaningful BCR could be become a useful and universal analytical tool for raters. Or at least the start of one.

The development of the BCR is the first step toward the development of group-wide global capital standards. The second step is development of Higher Loss Absorbency (HLA) requirements for G-SIIs. The third step is development of the risk-based group-wide global insurance capital standard (ICS), due to be completed by the end of 2016. Development of the ICS will be informed by the work on the BCR. And while the BCR will initially be applied to the G-SIIs, in time, the BCR will fall away as the more refined ICS measure is matured. Ultimately, it is the ICS that is the longer-term capital standard.

The revised ICPs have had – and, for now, will continue to have – the clearest and most direct effect on the majority of insurers. Very soon, the first ORSAs will be filed with U.S. state regulators.

ICP 16, which governs ERM, mandates that solvency regimes should require insurers to regularly perform ORSAs to assess the adequacy of their risk management and current and likely future solvency positions. The first U.S. ORSA filing will represent, in the words of Pennsylvania regulator Steve Johnson, “a game changer for the insurance industry.”

The ORSA represents a major step in solvency regulation modernization and, as Mr. Johnson indicates, may well be considered one of the most significant events in recent decades for insurance regulation in general and for ERM in particular. An integral part of proposed new solvency regimes globally, the ORSA symbolizes a commitment by both the regulators and the regulated to a customized, forward-looking system of solvency regulation, involving a more holistic real-time assessment of risk and its short- and medium-term impacts on insurers.

This bedrock change, for many U.S. insurers, is a prime example of international regulation becoming local.

There is also movement in the NAIC toward some form of direct holding company supervision that would be consistent with U.S. law. This derives from an ICP, and it would be reasonable to assume that more is yet to come.

This sea of regulatory change is extensive, and current timelines for the various stages of implementation stretch to 2019 and potentially beyond. Impact assessments of these regulatory requirements on an insurer’s underlying business model not only will identify the necessary process and system changes but also will go to the very heart of the business strategy.

To maximize their options, executives and management might want to immediately start understanding the potential impact, since strategic decision-making and price favorability require long lead times.

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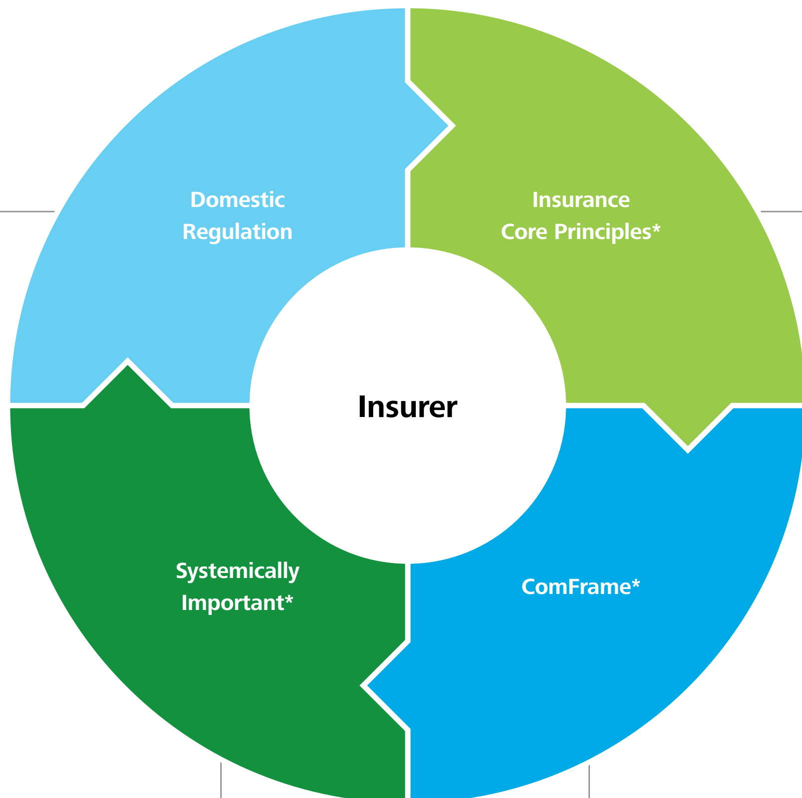
Figure 4. Global regulation affects all U.S. insurers

- U.S. domestic-only insurers are affected by IAIS initiatives indirectly through items like the insurance core principles
- U.S. global insurers are caught by domestic and global initiatives. In addition to ComFrame and systemic issues, U.S. global insurers need to navigate the various international regulators for the jurisdictions in which they do business, each of which may be adopting these requirements in different ways and with different timelines



NAIC
- State-based regime — implementing the ICPs, for example, ORSA and Governance

Fed
- SIFIs, G-SIIs, and those insurers subject to holding company supervision

Other
- Other regulators for example, FINRA, SEC

In the U.S., we have both SIFI and G-SII. We have systemic risk insurance parent companies based in the U.S. and subsidiaries of G-SII's. Enhanced supervision includes:
- Basic capital standards
- Recovery and resolution planning
- High loss absorbency
- Non-traditional and non-insurance

The common framework for the supervision of internationally active insurance groups
- IAIG designation criteria
- Group-wide supervision
- Risk management
- Insurance capital standards (current field testing)
- Supervisory cooperation (colleges)

26 insurance core principles (ICPs) adopted by supervisors around the world govern regulations. Many regulators are modifying their frameworks to comply, including the U.S.
- 26 ICPs include capital adequacy, use of models, risk management, suitability of individuals, governance, valuation, investments, market conduct, AML, group supervision and reinsurance

* IAIS initiative

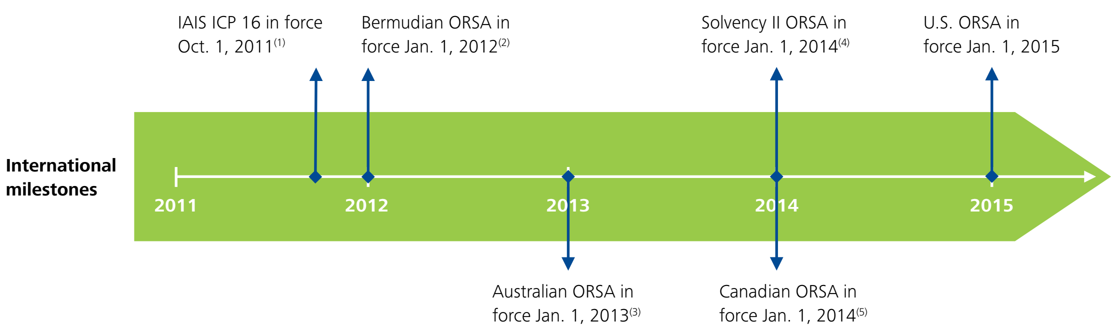
Source: Deloitte 2014.

How the interplay works

Understanding the impact of international regulatory trends on domestic insurers requires further assessment of the U.S. regulatory environment and its interplay with international requirements. The state-based system of regulation coordinated through the NAIC currently has a number of programs in place to help align traditional U.S. legal entity-based micro-prudential regulation with international regulation that is more group-based and macro-prudential.

A good example of this is the Solvency Modernization Initiative (SMI). The SMI is officially described by the NAIC as "a critical self-examination of the United States' insurance solvency regulation framework, and includes a review of international developments regarding insurance supervision, banking supervision, and international accounting standards and their potential use in U.S. insurance regulation. While the U.S. insurance solvency regulation is updated on a continuous basis, the SMI will focus on five key solvency areas: capital requirements, international accounting, insurance valuation, reinsurance, and group regulatory issues."[6]

Figure 5. The development of the NAIC ORSA has an international context



Sources:

1. IAIS, Insurance Core Principle 16 Enterprise Risk Management, Oct. 2010
2. BMA, Insurance Prudential Standards (Class 4 Solvency Requirement) Amendment Order 2010 (BR 94/2010)
3. APRA response letter review of capital standards for general insurers and life insurers, Dec. 2011
4. EIOPA, Final Report on Public Consultation No. 11/008 on the Proposal for Guidelines on ORSA, July 2012 – soft launch, so individual countries make their own decisions on timelines
5. OSFI, Guideline E-19: Own Risk and Solvency Assessment, Nov. 2013

Adoption of the U.S. ORSA may turn out to be the poster child for how international regulation is translated into domestic regulation. The group supervision paradigm that includes ORSA was a key element of the European Union's Solvency II Directive, which was incorporated into the new ICPs by the IAIS, with the NAIC then acting quickly to establish the U.S. ORSA.

While there are differences between the U.S and European ORSAs, the central truth is that this regulatory construct, originally conceived for European groups, is now part of the most significant change in insurance regulation for all U.S. companies since the introduction of risk-based capital (RBC). The downside for insurers, as suggested in our earlier reference to the regulatory multiplier effect in Europe, is that differences in ORSA requirements among jurisdictions, national or international, may add to the compliance burden on insurers without significantly increasing regulatory effectiveness or the safety of the system. Importantly, ORSA requires insurers to come up with their own views about the capital needs of their businesses. This may well be higher than the current RBC levels, since RBC is calibrated only to identify weakly capitalized companies. In contrast, ORSA is a process through which management must be able to demonstrate overall risk-based decision-making.

Though past performance does not guarantee future results, the introduction of risk-based capital may be a useful indicator of the wide-ranging nature of the change in which insurance regulation is currently engaged. Just as the current changes are being driven by problems uncovered during the financial crisis, the introduction of risk-based capital was driven by a string of large company insolvencies – first property and casualty and then life insurers – in the late 1980s and early 1990s, with a critical Congressional report blaming the failures in part on ineffective state regulation.[7]

Solvency regulation was very different in those days. Instead of risk-based capital, fixed capital standards were the primary solvency-monitoring tools. The NAIC recounts the history in understated fashion: "Under fixed capital standards, owners are required to supply the same minimum amount of capital, regardless of the financial condition of the company. The requirement imposed by the states ranged from $500,000 to $6 million and was dependent upon the state and the line of business that an insurance carrier wrote. Companies had to meet these minimum capital and surplus requirements in order to be licensed and write business in the state. As insurance companies changed and grew, it became clear that the fixed capital standards were no longer effective in providing a sufficient cushion for many insurers."[8]

Let's think about that for a moment. The solvency requirement was a fixed capital requirement that maxed out at $6 million, regardless of the company's capital condition? In retrospect, it seems self-evident that these fixed capital standards would not be effective in providing a sufficient cushion for many insurers.

While it might be tempting to dismiss changes such as ORSA as simply discrete regulatory elements that can be handled as separate events, a business historian reviewing solvency standards 25 years from now may well express the same incredulity about our current solvency tools as we do when looking back at the solvency tools that were in use 25 years ago. Similarly, it might take another decade or two to recognize the full impact of the current changes.

That being said, insurers must act now without benefit of hindsight. A strong argument can be made for proactive engagement, both with new regulations and with regulators and influencers. The bottom line is that all insurers will bear compliance costs for these regulatory changes, and while savvy insurers will attempt to minimize those gross costs wherever possible, it will likely be more useful in the long run to maximize the business benefits of the changes so that compliance spending is not incurred for activities that are treated as little more than regulatory exercises. That might mean investing in new capabilities that enable a company to effectively plan for, understand, and adapt to an ongoing stream of significant new regulation.

The SMI program has been in place since 2008 and continues to review the ICPs in order to determine if, when, and how to introduce them into the regulatory fabric for insurance here in the United States. Not surprisingly, there are stakeholders outside of the U.S. seeking to influence the decisions our regulators are making.

The IMF is conducting its mandatory review of the U.S. financial system, the Financial Sector Assessment Program (FSAP), in 2014 and 2015. For the insurance sector, that includes assessing the state-based system of regulation against the ICPs. This is an important measure of the perceived quality of U.S. insurance regulation. What the IMF report says could prompt further changes to the U.S. state-based regulatory system.

What could happen? Where will the IMF look? One indicator may be found in its report on the recent FSAP assessment of the insurance regulatory regime in Japan, which is led by the Japanese Financial Services Agency (FSA).[9] Key observations and recommendations focused on numerous areas, including:

- Governance
- Risk management
- Capital
- Wider use of enforcement tools
- Supervisory framework for categorizing regulatory performance

Another question may be how the IMF will react to ongoing changes in the U.S. regulatory system. These changes to the way our insurance companies are regulated include oversight from the Fed and the emerging role of the FIO (including its report on the state-based system of regulation and its implicit challenge to state regulators).

For example, the Fed regulates a holding company structure top down, with a capital and risk aggregation methodology. This is markedly different from the traditional state legal entity-based approach. Will the IMF try to use the Fed's example to force direct holding company regulation? It's worth noting that the Fed is the only organization that sits on the FSB, the IAIS, and the Basel Committee on Banking Supervision – all major organizations affecting or influencing financial services regulation.

What of the FIO, which seems more aligned in outlook with international regulators than the NAIC and might be interested in escaping the constraints imposed upon it as a non-regulator by Dodd-Frank? International regulators not used to what they may perceive as a fragmented U.S. system of state regulation are believed to favor a central representative. While the FIO is the designated representative under Dodd-Frank, the fact that the FIO is technically not a regulator limits its involvement in some ways.

Here again, it is worth remembering that the G20's FSB – the same organization that effectively demanded global capital standards over objections from U.S. state regulators and the insurance industry – called last year for insurance regulation in the U.S. to be centralized. The FSB's report said, "Given the drawbacks of the current regulatory set-up, the U.S. authorities should carefully consider and provide recommendations to Congress as to whether migration toward a more federal and streamlined structure may be a more effective means of achieving greater regulatory uniformity."[10]

If its July 2014 staff report can be considered a harbinger of the FSAP, the IMF might echo the FSB's call. In the report, the IMF said, "(T)he Federal Insurance Office should have a significantly larger role in the regulatory framework and be resourced accordingly."[11]

What's more, for insurers operating in non-U.S. jurisdictions, many national regulators are pursuing their own routes toward global regulatory convergence. The most important may be the oft-delayed but still looming Solvency II.

Final European guidelines have now been published for Solvency II. The Solvency II requirements focus on three pillars: (1) solvency, (2) governance/risk management, and (3) reporting/disclosures. The European Parliament adopted the "Omnibus II" Directive in March 2014, completing the "Solvency II" Directive and finalizing the new framework for insurance regulation and supervision in the EU effective in 2016. Firms affected by Solvency II must now assess each European state's response and planned rollout.

Next up: Show regulators the money

The NAIC has already enacted a number of key reforms, including ORSA, group solvency and regulation, and corporate governance. The next item of interest to U.S. insurers could be global ICS.

These standards are designed to apply to IAIGs under ComFrame. The IAIS defines an IAIG as a large, internationally active group that includes at least one sizeable insurance entity. To be classified as an IAIG, a group must write premiums in at least three jurisdictions, and the percentage of gross premiums written outside its home jurisdiction must be at least 10% of the group's total gross written premium. In addition, the group must have total assets of at least $50 billion, or gross written premiums of at least $10 billion, based on a three-year rolling average.[12]

Approximately 50 groups are expected to meet these requirements; however, there are concerns that the requirements may eventually spread to all insurers.

The primary challenge for U.S. insurers who have thus far operated under a legal entity supervisory framework is that a U.S. group capital standard does not currently exist. The secondary challenge is the question of what the capital requirement should be based on. For U.S. regulators, their main charge has always been policyholder protection, and their capital requirements tend to reflect that objective. This approach might need rethinking, as would the required capital levels, if it is decided that capital requirements should also be a tool to help maintain the stability of the financial system – which is a position some national and international organizations now posit.

Europeans, by and large, have welcomed the move to develop global ICS. European Insurance and Occupational Pensions Authority (EIOPA) Chair Gabriel Bernardino said in March 2014, "The introduction of global capital standards should help prevent regulatory arbitrage, increase financial stability, guarantee a level playing field and strengthen international supervisory coordination, for the benefit of the economy at large, including financial institutions, consumers and employees."[13]

Mr. Bernardino also stated, "Another important advantage of global capital standards is that they will reinforce the supervisory network by providing competent authorities with a common system. Global capital standards will facilitate the work of the colleges of supervisors that play an important role in an increasingly globalized market. With global capital standards, supervisory authorities present in the colleges will obtain a common understanding of qualitative and quantitative requirements for insurance groups, which is fundamental for the college's efficient, effective and consistent functioning."[14]

Americans have been less welcoming. In a June 6, 2014, comment letter to the IAIS, the American Academy of Actuaries said, "Given the variety of risks across jurisdictions (and even within a single national boundary), we question whether a single global approach that does not take into account localized jurisdictional capital requirements (that reflect localized risks, cultures, corporate governance and legal regimes) is advisable."[15]

A commentary by Fitch Ratings noted, "The U.S. National Association of Insurance Commissioners (NAIC) has already expressed serious concerns about the development of this standard. Other industry bodies have also expressed concerns or highlighted the challenges; the Geneva Association (an international insurance industry think tank) highlighted 'significant challenges to the creation of a global capital standard for insurers, particularly within the timeframe proposed.'"[16]

Rep. Randy Neugebauer, R-Texas, chairman of the Housing and Insurance Subcommittee of the House Financial Services Committee, said of the proposal, "Given the uniqueness of our regulatory model, this proposal has a potential to increase the cost for U.S. insurers, which would be borne by the policyholders themselves."[17]

How to respond to the new paradigm

The G20 and FSB continue to apply pressure for regulatory development, although there are differing views of the proper role of capital and capital standards. For now, however, the primary objective of insurance regulation in the U.S. remains policyholder protection.

Key changes include solvency, governance and risk management, and business strategy reforms. In addition, it is clear that traditional operating models now used to respond to compliance and risk must also change. Ultimately, a viable business model must be retained, and risk must be factored into the equation for business performance and profitability.

There is a new role for managing messaging to regulatory stakeholders, with a key objective being to demonstrate and provide evidence of business practices. Also, the role of the Chief Risk Officer – as well as the risk and capital framework – must be embedded and demonstrable in the decision-making process. Businesses can approach this challenge in many ways; however, it is critical to get it right in order to retain control.

Research in Europe by our colleagues Seb Cohen and Francesco Nagari has uncovered some obstacles to insurers creating a new approach to regulatory changes – obstacles that are likely to be similar for organizations in the United States. In their report, Cohen and Nagari observe that there are two main obstacles to higher performance in regulatory change and compliance teams[18]:

- Few insurers have a single view of regulatory change against which they can effectively plan.
- Regulatory competencies and insights are poorly represented in strategic decision-making and often fail to adequately support senior leaders as they make strategic decisions.

One possible way to deal with the current maelstrom of regulatory change is to integrate various disciplines into a single approach that recognizes uncertainty is at the core of regulatory issues.

This might mean creating a function tasked with achieving enterprise-wide coordination across core regulatory change activities; aggregating all these activities enterprise-wide; creating a coordinated response for foreseeable regulations and using scenario planning techniques for the unknowns; creating rapid response teams; and ultimately embedding a new *modus operandi* in organizations that would provide a framework for translating regulatory analysis into actionable plans.

Deloitte's regulatory planning approach

Figure 6.

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.

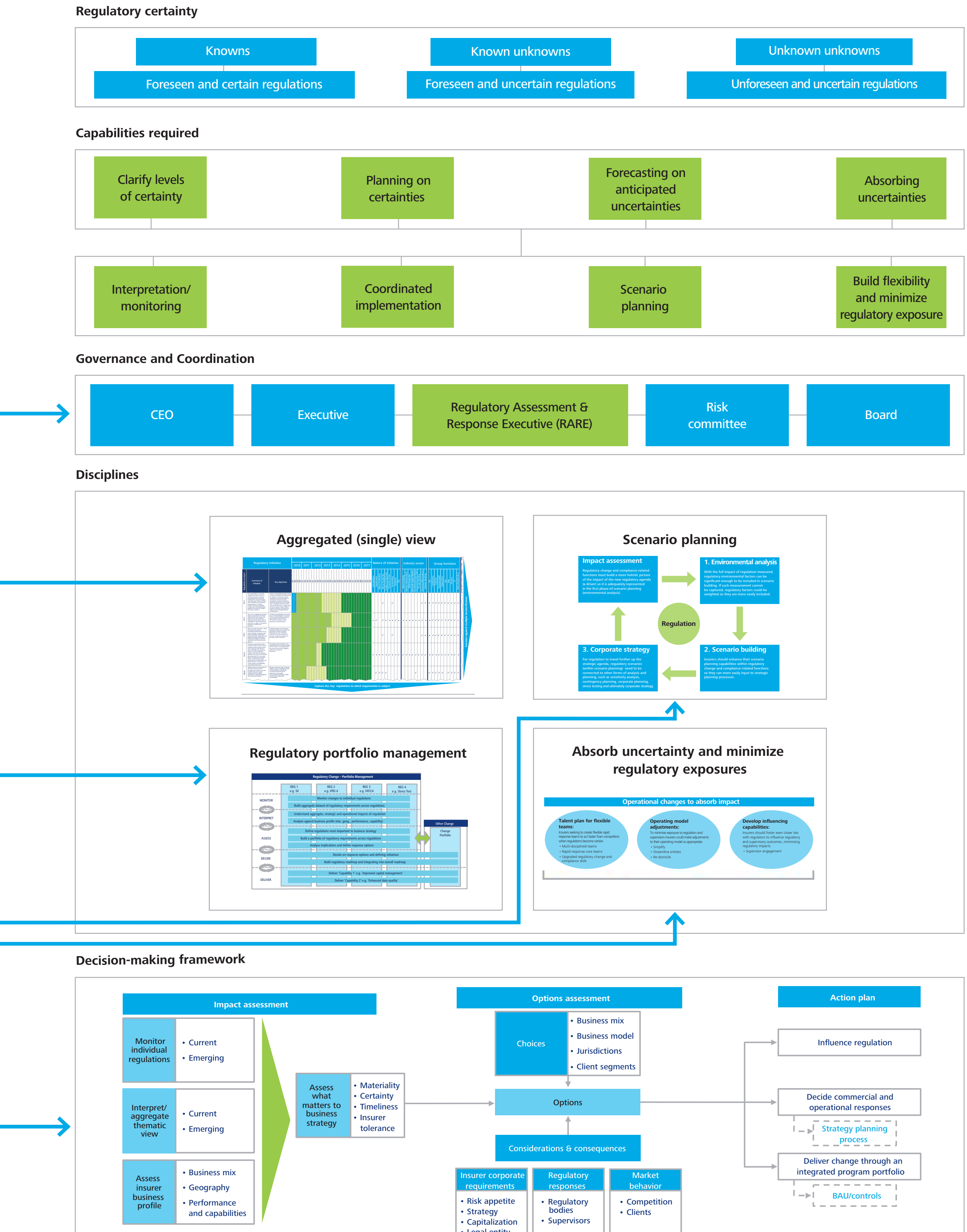
2. **Aggregated (single) view.** Create a single view of regulation across all regulatory change and compliance functions, through aggregated regulatory risk data and improved monitoring and interpretation of regulations impacting the firm.

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 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.



Source: Deloitte Insight, 2013

Conclusion

Some truths are self-evident. We are in a period of rapid and remarkable regulatory change – change driven by a global financial crisis that spurred a search for globally driven and globally encompassing regulatory solutions.

U.S. insurance companies that are large or operate across national borders are feeling the most immediate effects. They are the insurers most likely to endanger the financial system and thus are the ones being targeted by regulators. However, as demonstrated by ORSA implementation and corporate governance enhancements, all insurers, no matter how small or geographically limited, will likely be affected at some point.

It is reasonable to assume the trend of regulatory change is nowhere near done. This has two clear implications for U.S. insurers:

- Uncertainty is the *status quo* for the foreseeable future.
- Compliance costs will rise.

Insurance companies already facing low returns on their investments and slowly expanding economies will probably not welcome the need to spend more money on compliance. However, forward-thinking insurers may rightly view this period of change as an opportunity to create a new framework that leverages their compliance investments to improve their abilities to respond quickly and effectively to regulatory changes and to develop products that better meet the needs of both regulators and consumers.
New regulations cannot be ignored. The investment in compliance must be made. But properly understanding and managing the challenge may position an insurer for positive returns no matter what the future regulatory climate holds.

Endnotes

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Acknowledgements

The authors gratefully acknowledge the input, insight, and support of Sebastian Cohen and Francesco Nagari and their colleagues at Deloitte Insight (U.K.), whose research as detailed in **Rethinking the response: A strategic approach to regulatory uncertainty in European insurance** was foundational and whose assistance was vital in the preparation of this publication. The authors also gratefully acknowledge the assistance and advice of Courtney Scanlin and Rachel Moses.

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