This publication is part of the Deloitte Center for Regulatory Strategy Americas' cross-industry series on the year's top regulatory trends. This annual series provides a forward look at some of the regulatory issues we anticipate will have a significant impact on the market and our clients' businesses in 2017. The issues outlined in each of the reports provide a starting point for an important dialogue about future regulatory challenges and opportunities to help executives stay ahead of evolving requirements and trends. For 2017, we provide our regulatory perspectives on the following industries and sectors: banking, securities, insurance, investment management, energy and resources, life sciences, and health care.

We hope you find this document to be helpful as you plan for 2017 and the regulatory changes it may bring. Please feel free to contact us with questions and feedback at centerregstrategies@deloitte.com.
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Global foreword

The year 2016 has been another difficult one for the financial sector, with economic and political uncertainty complicating the completion of the post-crisis regulatory repair agenda.

A prolonged period of tepid economic growth and persistently low and volatile interest rates has squeezed profitability in some sectors and put significant pressure on longstanding business models and balance sheet management. Firms are further challenged by continuing uncertainty over the final shape of post-crisis financial regulation. While regulators are keen to preserve the hard-won reforms of recent years, rising political uncertainty in developed economies (as demonstrated by the UK's referendum decision to leave the EU and the US Presidential election results) has increased the volatility and hence unpredictability of the macro-policy environment. This has caused some to go as far as questioning the sustainability of free trade and open markets.

At the same time, the introduction of new technologies and digital distribution platforms in the financial sector are unleashing disruptive forces, promising benefits to consumers and markets and posing further challenges to the strategies (and margins) of established firms. New technologies also stand to multiply the cyber and IT risks the industry currently faces. Nevertheless, if properly harnessed, these technologies also present opportunities for incumbents which move quickly and wisely to revitalize their business models.

The year 2017 will begin with a range of highly anticipated regulatory developments at or near their finalization. The Basel Committee on Banking Supervision (BCBS) is expected to conclude most of its banking framework; recovery and resolution planning is expected to move closer to being implemented for most large banks and increasingly clarified for non-banks; and markets are expected to continue to shift toward central clearing and higher standards for transparency. How these reforms and new regimes are implemented in national jurisdictions will, however, be more sensitive to concerns about going too far and potentially harming an already weak economic recovery. The risk of fragmentation of global regulatory approaches is rising.

From a supervisory perspective, compliance with these new requirements is the bare minimum; as important will be firms' preparedness for the unexpected. Supervisors will, more than ever, want to see that firms have in place robust plans for scenarios that could threaten their own stability or the interests of their customers.
Strategies for a more constraining regulatory environment

Despite the uncertainty that characterizes 2017, one fact is becoming increasingly clear: Financial services firms will not be able to wait out this current period of difficulty without taking decisive and, in some cases, bold actions in response. 2017 marks nearly a decade since the circumstances surrounding the financial crisis began, and many of the problems the industry has faced over this period are now starting to look more structural than cyclical. Despite a view in some quarters that the “regulatory pendulum” has swung too far, given the tastes of many politicians worldwide (if not those of supervisors as well), the regulations that have already been implemented to date are unlikely to be materially watered down—at least not soon. If interest rates stay lower for longer in major markets, many bank and insurance business models will need to be rethought. Yet rising interest rates would not be a panacea either, given the pressure it would put on (household) borrowers and counterparties with fragile balance sheets.

As a result, firms need to refresh their strategies for how they respond to regulation and how they do business in a regulatory, economic, and political environment that could be fundamentally more constraining. Not all firms will succeed in doing this in the year ahead. Those that do will be those that find ways of making this new environment work for them, capitalizing on their inherent resilience, agility, and efficiency.

It is in this fluid context that we present the Deloitte Center for Regulatory Strategy Americas’ Regulatory Outlook for 2017. This gives our view on how regulatory themes will shape the financial industry in the year ahead and how firms can respond to the challenges they will face.

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Introduction

The 2016 election results may, over time, reshape the insurance industry’s regulatory landscape. Key policy issues—such as the designation of large insurance companies as systemically important financial institutions (SIFIs), certain provisions of Dodd-Frank affecting insurance companies, and the Department of Labor’s (DOL) “Conflict of Interest” Rule—face uncertainty. But there are also important regulatory influences that will continue to shape the 2017 agenda on the topics of capital standards and consumer protection. Complicating the picture for insurers is that the federal agenda may be quite different from states that are very active. Time will tell how these events may impact the industry.

As companies look for clues and direction to help guide their compliance strategies, actions, and investments in 2017 and beyond, they need to be proactive and pay extra attention to regulatory changes as they unfold, as the industry’s regulatory trajectory may shift. That said, most of the boldest ideas to amend or repeal existing statutes and their implementing regulations would need to go through the full legislative process. Revising other regulations or guidance would be relatively easier, but there’s still a process to follow and the scope of such revisions would be narrower.

On the other hand, companies should also make a conscious effort to avoid being paralyzed by uncertainty. With so much change in the air, it can be tempting to just sit back and wait for things to settle down. But until changes are officially announced and approved, compliance with existing regulation is paramount.

Also, it’s important to note that firms have invested considerable money and effort in key regulatory-related activities—such as enhancements to risk management and compliance frameworks. These investments can be expected to deliver long-term business benefits regardless of the specific regulations that are enacted.
Taking all these factors into account, here are the regulatory trends we believe will have the biggest impact on insurance companies in 2017:

- Multiple regulatory influences
- Own Risk Solvency Assessment (ORSA): The evolution
- Department of Labor (DOL) fiduciary standards:
  - Conflicts of interest in retirement accounts
- Cyber technology
- Acquisitions from abroad
- Corporate governance
- Principle-based reserving (PBR)
- Regulatory response to digital technology
- Market conduct
- Longevity risk charge
- Long-term care
- Form F: Potential changes to enterprise risk reporting
- Group regulatory capital initiatives

In this report, we explore each of these trends based on what we know now, with additional insights about high-level views on potential regulatory changes. However, in 2017 we may very well find that nothing is certain until it actually happens.

To stay on top of the latest regulatory news, trends, and insights, we invite you to visit our website at www.deloitte.com/us/about-dcrasamericas.
Multiple regulatory influences at the state, federal, and international levels continue to present significant challenges for the industry—particularly for insurers designated as SIFIs, as well as those that own a depository institution. However, over the past year there have been some important developments that are helping to reduce regulatory confusion and uncertainty.

One of the biggest developments was a long-anticipated speech by Governor Daniel Tarullo of the Federal Reserve Board (FRB). In his speech, Tarullo indicated that the FRB’s approach for determining the additional capital requirements for insurers with depositories would largely be consistent with the approach already in use by state regulators. This was welcome news for the many insurers that were worried the FRB might adopt its own methodology, making the compliance challenge even more complex and burdensome.

It should be noted, however, that the approach for SIFIs could be very different. Following Governor Tarullo’s speech, the FRB issued an advance notice of proposed rulemaking (ANPR) on June 3, 2016, inviting comment on separate capital requirements for SIFIs and depository institution holding companies significantly engaged in insurance activities. In a statement accompanying the ANPR, Governor Tarullo noted that the dual approach illustrates the FRB’s “efforts to tailor capital regulation to the different risks posed by financial intermediaries of varying types and complexity.” The public comments on the ANPR, which were due on September 16, 2016, are still being reviewed.

Although the FRB’s exact methodology and capital requirements are still being determined, the announcement was an important step toward greater regulatory alignment at the federal and state levels. It was also a subtle push back on emerging regulatory initiatives at the international level that might not be favorable for the US insurance industry. For example, the International Association of Insurance Supervisors (IAIS) is actively working on International Capital Standards (ICS), as well as a common framework (ComFrame) that strives to define a common standard for Globally Systemically Important Insurers (G-SIIs) and Internationally Active Insurance Groups (IAIGs). Although the capital standards are still being defined and their exact form of implementation remains unknown, capital measures are just one part of a suite of measures regulators are working on. Other regulatory developments may also have a meaningful impact on insurers and should be closely monitored.

Rising regulations and tighter restrictions on capital—amplified by the complexities of multiple regulatory influences—may drive up compliance costs and prompt insurers to pursue new growth strategies. Every insurer must take a hard look at its business model and associated regulatory profile to understand the impacts of these new regulations and then choose an appropriate strategic response.

To keep pace with the changes, insurers need to actively monitor regulatory developments at the state, federal, and international levels—engaging with regulators as needed to help shape those developments. In addition, insurers can get a head start by responding to regulatory consultation documents and by taking part in regulatory initiatives, such as field tests or pilot studies. Road testing new regulatory standards can help inform the regulations, while also helping insurers understand the industry impact so they can get ahead of the curve and start making the necessary adjustments to their business operations and strategies. This will enable insurers to position themselves for success in the regulatory environment of the future.

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Own Risk Solvency Assessment (ORSA): The evolution

ORSA is a state-based requirement. Companies subject to ORSA filings are required to submit an annual filing to their state department of insurance detailing the company’s own assessment of its risk profile, the processes in place to manage risks, the potential impact of those risks, and a view on solvency. It’s important to note that while the ORSA is an annual filing, it’s intended as a broader risk management and capital process—part of which is a report to the company’s board of directors that’s also shared with regulators as an ORSA filing.

The Risk Management and Own Risk and Solvency Assessment Model Act (RMORSA) has been in effect since January 1, 2015, but state legislatures have had different adoption timelines. This led to a staggered start for ORSA. However, many states have now adopted it, and regulators are starting to provide feedback to companies about their ORSA filings. When the model law was adopted by the National Association of Insurance Commissioners (NAIC), ORSA was described as a “game changer,” and its implementation was expected to be an “evolution not a revolution,” with regulators understanding that first year filings may not be as robust as subsequent years when ORSAs became more seasoned. As a result, companies filing ORSAs and meeting the underlying requirements are still evolving their risk and capital capabilities, digesting their regulatory feedback, and readying themselves for their first ORSA examinations.

Companies that have been successful with ORSA implementation have taken time to understand its components, used it as an opportunity to enhance their own risk and capital frameworks, and sought to drive business value from the ORSA process.

The key challenges are:
• Demonstrating embedded enterprise-wide risk and capital management processes
• Developing the people, processes, and technology to make those overall processes work
• Driving value out to the business

In today’s low interest-rate environment, companies are trying hard to manage costs and improve underlying profitability. The ORSA process helps them further understand their risk profiles and risk appetites, as well as how best to manage the risks they face in order to drive value and avoid losses.

Most companies have already filed a successful first ORSA or are in the process of filing one. And as more companies receive regulatory feedback, a clearer sense of what’s acceptable to regulators will emerge.

Armed with prior-year filings, companies will understand where the weaknesses in their risk and capital frameworks reside and where improvements can be made. It’s important to take action on these opportunities in order to derive the most value from the ORSA process.
Navigating the year ahead: Insurance regulatory outlook 2017

The DOL's “Conflict of Interest” rule (the Rule) has been final and effective since June 2016. Based on the results of the 2016 presidential and congressional elections, there is considerable conjecture whether the current Rule will remain viable, and if the April 10, 2017, applicability date will be delayed. Although there may be avenues for the new presidential administration and incoming 115th Congress to delay, repeal, or substantially change the Rule, each of these avenues may face significant challenges. Potential modifications could result in the delayed applicability date and increased emphasis on client disclosures.

At the moment, due to the many unknowns to confidently assess the likelihood of the action being taken with respect to the Rule, we’re observing our clients continuing their robust efforts to prepare for the Rule. While some have begun to conduct scenario planning efforts should the Rule be delayed, repealed, or amended in some manner, most firms have made clear choices on changes to their business models, product shelf decisions, compensation choices, exemption strategy, and plans to proceed with implementation.

As 2017 unfolds, we may see a challenging first quarter due to the many effects of the Rule on business operations. Some of the prominent efforts in insurance companies will be focused on the following key areas:

• Distribution arms will finalize their product shelf decisions in order to meet best interest standards; this will likely result in the removal of some mutual fund and annuity manufacturers as approved product providers due to their fees/costs, performance, service, or credit rating, among other factors

• Reasonable compensation analysis will continue to streamline share class and payment options as distribution partners work with manufacturers, and there are expected reductions in certain product sales charges

• Insurance broker-dealers will continue to offer a choice of commission-based and fee-based advisory service models—which may contrast with service model choices by other financial services providers

• Significant efforts will be placed on evaluating vendor systems to fill key operational and data needs (e.g., 401k rollovers, disclosure on demand requirements, etc.) and developing workable Day 1 solutions to some of the more vexing operational and compliance challenges

• Training curriculum and delivery to agents, registered representatives, investment...
advisers’ representatives, supervisory principals, and other fiduciaries will be a major focus, with a range of internal and external solutions, using both on-line and in-person training.

- DOL Rule governance models, field- and home-office supervision, and compliance policies and procedures will be developed and implemented, with a critical dependency on third-party systems to support more robust best-interest and documentation requirements.

- Adapting the implementation of DOL rules to insurance marketing organizations (IMOs) will remain a major challenge; the industry will await potential DOL clarification or financial institution status on an individual IMO or class basis.

- In-house information technology (IT) teams will work earnestly to implement changes to product, compensation, operational, compliance, and administrative systems supporting DOL Rule requirements.

Training curriculum and delivery to agents, registered representatives, investment advisers’ representatives, supervisory principals, and other fiduciaries will be a major focus.
Cyber technology

Cyber technology is a major issue that regulators are grappling with as they seek to adapt insurance regulation to the tools and innovations available both to the industry and regulators. The biggest issues at the moment are cybersecurity, big data, and privacy.

- **Cybersecurity** can be viewed in terms of opportunity and cost. Opportunity refers to capitalizing on digital innovations to create new insurance products and to operate more efficiently and effectively. A key opportunity is cyber insurance, an area that’s growing by leaps and bounds but remains fraught with uncertainty because of difficulty measuring risk. Cost refers to the need for insurers to securely maintain customer information that’s often highly confidential but also highly sought after and valuable. Data breaches are costly to defend against but even more costly to repair—both in terms of dollars and reputational damage.

- **Big data** is the newest buzzword among insurance regulators. Part of the challenge is that regulators can’t agree on a definition of what big data is, but in general it refers to the agglomeration of all existing data on consumers to aid in claims, marketing, fraud prevention, and many other aspects of the insurance business.

- **Privacy** is a persistent issue in all aspects of cyber technology, including cybersecurity and big data. Problems in this area often trigger a significant regulatory and political backlash.

Regulators at the NAIC have created a white paper on big data, as well as two versions of a cybersecurity model act. Industry expressed strong concerns about both versions. Scope and cost are key concerns for industry, as is the potential legal liability. Meanwhile, other regulators have entered the arena. New York’s Department of Financial Services was the first to unveil a proposed cybersecurity regulation. Also, the FRB—along with other federal financial regulators—has issued an advance notice of proposed rulemaking on the issue.

The existence of multiple regulatory structures for cybersecurity could raise a number of issues, including potential duplication and added costs. However, in the event of cyber breaches, insurance companies might find it’s more challenging to defend themselves in court without the “safe harbor” provided by standards, leading practices, and a codified structure—all of which reduce the potential for variable and uncertain interpretations by different jurisdictions and juries.

Big data is in many ways the Holy Grail for insurers, theoretically enabling them to analyze and segment existing and potential customers and to optimize return on investment while minimizing everything from fraud and underwriting losses to marketing costs. However, consumer groups have expressed strong concern about unrestricted use of big data by insurers, and regulators have responded by holding hearings and actively moving to regulate such use. Ironically, regulators themselves may end up harnessing the power of big data and predictive analytics to address a wide range of challenges, including the proactive and timely monitoring of market conduct.

Big data is a key enabler for cyber insurance and is creating many other opportunities for insurers to monetize the large and rapidly growing pool of available data. As the “Internet of Things” expands, the amount of data available to insurers could skyrocket, potentially enabling them to become one-stop risk management shops for clients—a breakthrough that could transform the current segmented insurance model.

To address the opportunities and challenges created by cyber technology, insurers should evaluate their current cybersecurity measures to ensure they provide sufficient security, vigilance, and resilience. Insurers should examine available proprietary data and look for ways to apply and monetize it through innovations and improvements in marketing, claims, fraud prevention, and other areas. Also, they should understand how regulatory restrictions might restrict the use of big data, as well as how regulators themselves might use big data to enforce compliance.
Navigating the year ahead Insurance regulatory outlook 2017

Acquisitions from abroad

In terms of deal value, 2015 was the most active year for insurance mergers and acquisitions (M&A) in history—and a significant portion of those were done by foreign acquirers. In fact, the awakening of foreign acquisitions was potentially the story of 2015. However, in 2016 there was a slowdown in acquisitions from abroad, seemingly fueled by regulatory concerns.

Foreign companies are looking to export capital and diversify away from their home markets by acquiring US-based insurance companies. The US insurance market is the largest in the world. While it’s growing slowly on a percentage basis, on a dollar basis it’s growing as fast as any market in the world. This makes the US a very attractive option, especially for insurers in China and Japan. However, regulatory approval is a requirement for all deals, and regulatory issues seem to be a key factor in the recent slowdown for in-bound deals from abroad.

Large Chinese conglomerates that are heavily invested in real estate need to diversify and would like to invest in the US insurance market. But not much is happening at the moment. Foreign companies may be waiting for another company to blaze the trail and provide a blueprint on what it takes to get approval from the relevant regulatory bodies. This could trigger another wave of acquisition activity.

For acquisitions from abroad, regulators seem most concerned about governance and capital deployment effects and less about anti-trust issues.

Domestic deals may happen as well, but they are likely to be on a smaller scale. The US Department of Justice (DOJ) allows many deals to proceed since the industry is so fragmented. However, large deals get intense scrutiny because the DOJ doesn’t want the biggest players (typically top three) to get even bigger. Also, smaller players want to avoid becoming SIFIs, so the size and volume of their M&A deals tend to be limited.

The insurance business has many structural realities that stimulate M&A activity, making it almost certain that more acquisitions and consolidation will happen in the future. We just don’t know the timing and magnitude. Companies should monitor in-bound acquisitions from abroad, keeping a close watch for a deal that cracks the code and gains regulatory approval. This could open the floodgates for another wave of acquisitions.
Corporate governance

According to the NAIC, “Corporate governance defines all organizational roles, responsibilities, and accountabilities at all levels. It describes and explains the management hierarchy, that is, the decision-making and accountability chain and ultimately who has the power to manage and legally represent the company in all settings. Corporate governance spells out requirements for documenting decisions and actions as well as the thinking behind them. It also provides for corrective action for non-compliance or weak oversight, controls and management.”

The NAIC adopted enhanced corporate governance model laws and regulations that states began to enact in 2016. Thus far, only five states have officially enacted the model law. However, a number of other states are actively considering it, and all states are expected to adopt it before it becomes an accreditation standard. For insurers, this new oversight imposes a greatly increased level of regulatory scrutiny, both on corporate actions and potential actors—including board members and executives.

Compensation, qualifications, and risk oversight structure are but a few of the many areas to be examined under this enhanced corporate governance regime. And since there are no exceptions to the complex and far-reaching model, insurers—especially smaller ones—will likely need to seek an external evaluation of their current corporate governance model before reporting to their state of domicile. An external evaluation is especially important given that the model gives regulators the authority to use external evaluators for their own assessment of an organization’s corporate governance structure.

Compensation, qualifications, and risk oversight structure are but a few of the many areas to be examined under this enhanced corporate governance regime.
Principle-based reserving

PBR for life insurance companies is a dynamic replacement for the current reserve requirement approach, which is based on a static formula. As a dynamic approach, PBR is designed to more accurately reflect today’s more complex life insurance products—as well as the increasingly complicated environment in which insurers operate.

PBR may be the single most important change to life insurance reserving in many years. If enacted as designed, it will allow insurers to “right size” reserves, narrowing the gap between statutory and economic reserves and possibly freeing up capital for other uses. At the same time, it will require insurers to change their reserving standards. Therefore, it could affect the product mix insurers find most profitable. Many believe it could also require insurers to modify their skill set.

PBR adoption has been one of the NAIC’s highest priorities. Final adoption required approval by a supermajority of the states representing a supermajority of the affected premium. That requirement has now been met, enabling PBR to go into effect on January 1, 2017. Although there is a three-year phase-in period before PBR becomes mandatory, some insurers have indicated they will begin using PBR for one or more products the moment it takes effect.

One concern that has been expressed by many US and international regulators is the use of affiliated captives by life insurers. Insurers have justified this use by citing the difference between required statutory and economic reserves. PBR might not entirely eliminate this difference. It could, however, help regulators justify more intense scrutiny of captives.

Under PBR, insurers might be able to offer more complex products with lower cost reserves than would have been possible under the formula-based system. This could expand the market available to life insurers. Based on recent discussions at the NAIC, it seems that talent might be a big issue.

Insurers need to make sure they have enough people with the skill set necessary to satisfy PBR’s requirements, including the development and use of sophisticated models.

Some insurers haven’t yet begun to set up the framework for PBR adoption because they were uncertain of the timetable. But now that the January start date has been officially established, these insurers can begin marshaling the internal and external resources necessary to create the framework.

As they look ahead, insurers might want to evaluate their product mix and pricing strategies, since product development and product pricing could both be affected by PBR.
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Regulatory response to digital technology

Digital innovations are creating new and unforeseen opportunities and challenges for insurers and regulators alike. For example, digital technology has already enabled a shared economy in which cars and homes have multiple users who may have divergent insurance requirements. Autonomous vehicles are looming on the near horizon. These developments could have a significant impact both on individual insurance companies and on the overall insurance structure—a structure that was built around the traditional norms of owner-occupied homes and human-driven automobiles.

For insurers, technology innovations are creating significant opportunities. For example, a growing number of companies are incorporating telematics technology into their automobile insurance offerings. Also, many insurers are harnessing the power of new developments in financial technology (fintech) by purchasing or partnering with fintech companies, or by creating their own internal innovation units.

The biggest change—and challenge—for the insurance industry might be the pace of change itself. For example, home-sharing sites have grown at an exponential rate, dwarfing the growth rate of the traditional hotel and lodging industry. Similarly, blockchain is a rapidly emerging technology with the potential to streamline and transform many insurance interactions. This rapid emergence and convergence of new digital technologies disrupts the status quo, both for insurers and the regulators that govern them.

For insurers, there’s a dual imperative. The first is the need to not fall behind. Even in situations where there isn’t a significant first-mover advantage, falling too far behind in the race to adopt or adapt a new technology could mean falling out of the race completely. For an industry such as insurance that’s accustomed to carefully evaluating data in the rear-view mirror, this new fast-paced environment may require companies to change their mind-set and embrace uncertainty. The second imperative is to maintain contact and influence with regulators as they adjust to technology-driven change.

The insurance industry—and its associated regulatory environment—has been thriving and adapting to change for centuries. But as the impact of digital innovation on the taxi business demonstrates, a regulatory environment that isn’t sufficiently nimble and flexible can significantly hurt an industry’s growth prospects.

For insurers, the optimal approach to dealing with the current maelstrom of regulatory changes—including those driven by technology innovation—is to integrate various disciplines into a single function that recognizes uncertainty is at the core of regulatory issues. This integrated function would be responsible for:

- Providing enterprise-wide coordination across core regulatory change activities
- Aggregating all those activities across the enterprise
- Creating a coordinated response for foreseeable regulations (using scenario-planning techniques for the unknowns)
- Creating rapid-response teams
- Ultimately embedding a new modus operandi in organizations that would create a framework for anticipating and responding to regulatory change
Market conduct

The NAIC and various state insurance departments continue to devote considerable attention to the evolving set of market conduct challenges. A number of NAIC task forces and working groups have been focusing renewed attention on key areas revolving around consumer protection, particularly the need to protect seniors as the US population ages.

Insurance products receiving special attention include long-term care, Medicare supplements, contingent deferred annuities (CDAs), and creditor-placed insurance. Also, in 2016 the NAIC and various state insurance regulators worked to develop a formal regulatory accreditation/certification proposal for market conduct examinations. While the market regulation accreditation program will likely not go as far as the existing formal accreditation program for financial solvency regulation, it could still have a profound impact on both insurers and regulators. The proposal will likely be finalized in 2017 for consideration by the full NAIC membership.

In 2016, the Market Regulation Certification (D) Working Group was tasked with drafting a formal market regulation accreditation proposal that would provide recommendations in a number of key areas. These areas include proposed accreditation standards, a suggested process for individual state implementation of the proposed standards, a process for measuring compliance with the standards by individual states, and a suggested process for making future revisions to the standards. Although the details have yet to be finalized, the NAIC is contemplating some type of financial incentives for insurance departments that achieve full certification.

Unlike the NAIC’s existing financial solvency accreditation program, which was established in the late 1980s and early 1990s, the proposed market regulation certification program would allow states to “self-certify” in the initial years of the programs. Therefore, it would likely not lead to similar uniformity of standards and examination practices. Some regulators have expressed concern that the proposed program would cause individual states to lose some autonomy related to market conduct examinations. Others have argued the program should be optional, not mandatory. As a result, the proposed market regulation program may not have the same impact on insurers as the financial solvency accreditation program.

That being said, some regulators and industry observers are optimistic that the proposed program will lead to better coordination among the states over the timing and frequency of exams and raise the professionalism of individuals conducting the exams. In 2017, there will likely be continued focus on this proposal as the NAIC and individual state regulators finalize the details of the draft.

The NAIC’s ongoing focus on consumer protection in such key areas as cybersecurity, data protection, and sales practices (especially sales practices that target the aging population) could create increased regulatory burdens on US insurers, producers, third parties, and other service providers. In particular, the Market Regulation and Consumer Affairs (D) Committee has been focusing on insurers’ use of big data in areas such as claims, underwriting, product development/pricing, and marketing—as well how that data could be used to improve the efficiency and effectiveness of market regulation. The work of this group—and the resulting recommendations—will likely come under close scrutiny from the industry in 2017.

As a result, the proposed market regulation program may not have the same impact on insurers as the financial solvency accreditation program.
Longevity risk is the risk that a life insurer will lose money if actual survival rates and life expectancy surpass expectations and assumptions. The NAIC has created a Longevity Risk (A/E) Subgroup to provide recommendations for recognizing longevity risk in statutory risk-based capital (RBC) of US life insurance legal entities writing certain kinds of products.

A broad number of factors and trends are driving these changes, including:

• Rising life expectancy due to improvements in medicine, safety, health care, etc.
• Greater resources necessary to support aging populations, especially as Baby Boomers retire
• Changes in corporate and governmental retirement benefits, particularly the shift from defined benefits (pensions) to defined contributions
• The financial downturn and volatility in capital markets
• The low interest rate environment, which compounds the impact of longevity risk

• The growing trend of non-US insurers ceding longevity risk to US insurers for regulatory arbitrage purposes

A potential longevity charge for life RBC will require additional regulatory capital for insurers writing certain types of products. Also, with no visible legal entity capital charge, the US state regulatory solvency framework may appear deficient and receive international and federal criticism.

Significant work is needed to establish appropriate metrics and assumptions and to collect data. Key challenges include avoiding double counting with existing reserve margin and assessing diversification benefits and/or correlation considerations.

With additional data and metrics becoming available to assess longevity risk, rating agencies will be able to enhance their respective capital formulas and expectations. This will likely coincide with heightened expectations for reserves and asset adequacy testing.

The increased cost of capital to address longevity risk will likely be passed onto consumers. Meanwhile, mitigation strategies will evolve, including potential changes to product features (such as caps on benefits). Risk transfer vehicles such as longevity bonds will also evolve and expand.

Business challenges include developing strategic planning, projections, stress testing, and new product offerings that fully consider the risks related to the enhanced regulatory protections. There may also be an opportunity to enhance enterprise risk management (ERM) frameworks and internal capital modeling (e.g., ORSA reports) in order to prepare in advance for this likely new regulatory requirement.

To get in front of the issue, companies should follow the relevant NAIC committees; engage chief risk officers (CROs); and re-evaluate their internal capital, reserves, and asset adequacy assumptions associated with longevity risk. They should also speak with rating agencies about potential implications of the changes.
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Long-term care

Long-term care insurance reimburses policyholders for daily long-term services and support, such as home health care, nursing home care, and hospice. The US population is living longer, so demand for this type of product is growing exponentially. However, a variety of issues are prompting increased regulation and scrutiny in this area.

Many long-term care (LTC) products, written as far back as the 1960s, were inappropriately modeled and underpriced. However, rate increases are difficult for many policyholders to afford, making it challenging for states to grant the necessary increases. Also, there have been a number of large LTC insurer run-offs and receiverships, which will likely cost life and accident and health (A/H) insurers millions in guaranty fund assessments during future liquidations, since those insurers are legally required to fund such assessments. Guaranty fund caps, which vary from state to state, are estimated to leave future liquidated estates with billions in unfunded policyholder obligations.

Having billions of dollars in unfunded policyholder obligations and other claimants is likely to draw significant attention from federal regulators and federal policymakers. This could create an atmosphere of increased federal scope creep and preemption.

NAIC is discussing significant innovations to increase the number of affordable asset protection product options available to meet growing demand in the US. Possible changes include everything from product modifications and state and federal incentives to reduction in regulatory restrictions.

For now, life and A/H insurers have an opportunity to participate in the discussions and improvements so as to reduce or limit future guaranty fund assessments, which could have a significant impact over the next few decades due to liquidation of insurers writing LTC. At the very least, insurers should follow the relevant NAIC committees and trade association activities in order to stay informed about emerging developments and changes.

Having billions of dollars in unfunded policyholder obligations and other claimants is likely to draw significant attention from federal regulators and federal policymakers.
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Form F: Potential changes to enterprise risk reporting

Enterprise risk reporting Form F is a filing where the ultimate controlling person/entity of an insurer subject to the filing identifies the material risks within the insurance holding company system that could pose enterprise risk to the US domestic insurer. However, a recent survey indicated that regulators aren’t pleased with the filings as the responses don’t provide enough information about significant risk considerations.¹

The NAIC is creating a guidance manual and/or best-practice document to illustrate how to provide more complete and thoughtful responses to the Form F items. The primary focus will be on non-insurance risks within the holding company system.

One concern for insurers is that the desired in-depth responses could identify weaknesses in a holding company system’s ERM framework—specifically, that it’s not comprehensive enough or doesn’t allocate enough resources to adequately assess the risks of non-regulated entities within the group. Also, the desired responses could exceed the expectations of current Securities and Exchange Commission (SEC) disclosures.

Some possible additional holding company system narrative disclosures include IT considerations; listing key inherent risks that are being mitigated by controls; additional disclosure on the group business plan; and additional disclosure of internal audit findings, compliance, and risk management.

Insurers have an opportunity to get in front of this issue by enhancing the holding company system ERM framework to be more comprehensive and provide better coverage of non-insurance group activities. At a minimum, insurers should stay abreast of developments by the Group Solvency Issues (E) Working Group and develop internal plans for responding to potential changes as appropriate.

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Group regulatory capital initiatives

A number of group capital requirements are currently being developed and readied for implementation at both the domestic and international level. This is a new experience for the US insurance industry, which has never before had to contend with a group regulatory capital standard or calculation. Insurance groups determined by supervisors to be subject to the requirements will have to comply with the new group capital standard/calculation, in addition to any legal-entity capital standards that may already apply.

Separate initiatives are currently underway at all three geographic levels:

- **International.** Under the auspices of the Financial Stability Board, the IAIS has already developed a basic capital requirement (BCR) and is in the process of developing an insurance capital standard (ICS), with ICS version 1.0 to be agreed upon in 2017. The ICS development is perhaps the furthest ahead and could trigger changes in a variety of areas, including:
  - **Valuation methodology.** A market-adjust valuation (MAV) and a Generally Accepted Accounting Principles (GAAP) Plus basis are being considered.

- **Federal.** In early 2016, the FRB approved an advance notice of proposed rulemaking (ANPR) inviting comments on the proposed capital standard. The FRB is looking to develop a group capital standard using a building block approach for US domestic insurance companies that own a bank or a thrift and a consolidated approach for insurance companies designated a SIFI by the Financial Stability and Oversight Council (FSOC).

- **State.** During 2016, state-based insurance regulators—coordinated by the NAIC—began the process of constructing a US group capital calculation for insurers using an RBC aggregation methodology. The NAIC’s Group Capital Calculation Working Group is tasked with liaising with the FRB during its mutual consideration of a group capital standard/calculation.

To achieve compliance, insurers will need to operationalize the requirements. Depending on the specifics of the capital standard/calculation, this could require a significant investment in resources, including systems to calculate asset and liability values; new processes to collect required data; revised controls to provide an adequate comfort level for the production of the requirements; and revised reporting and governance processes to enable successful filing. In addition, companies will need to consider the strategic implications in such areas as product pricing, return hurdles, eligibility of capital, and current practices versus new regulatory requirements. There may also be strategic opportunities where competitive advantage could be gained.

Insurers should get up to speed on the various initiatives that are currently in progress and then analyze the implications for their businesses. They may also want to help shape the regulations by providing input and engaging with the organizations that are formulating the requirements.
Looking ahead

From a regulatory perspective, 2017 is shaping up to be a year with more than the usual uncertainty. In this dynamic and unpredictable environment, insurance companies would be well-advised to focus extra attention on keeping up with the latest regulatory trends, while at the same time continuing to do all that’s needed to achieve compliance with existing laws and regulations.

At the Deloitte Center for Regulatory Strategy Americas, we will be continuously monitoring and analyzing new regulatory developments as they unfold throughout the year.

For the latest news, trends, and insights, please visit our website at www.deloitte.com/us/about-dcrsamerica.
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