

Pre-financial crisis vs. post-financial crisis

The 2008 financial crisis had a major impact on US insurance regulation.

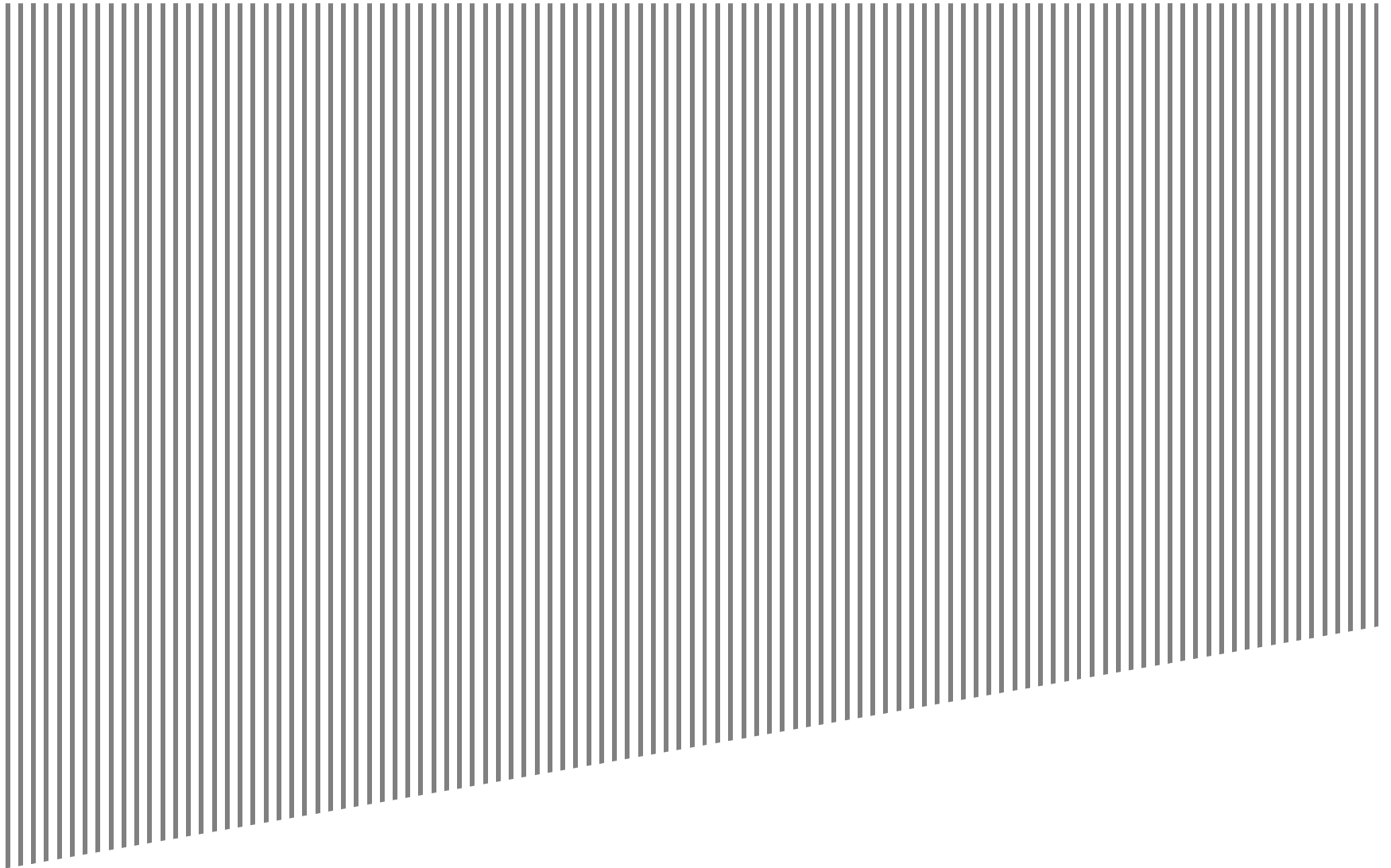
Pre-financial crisis

- ▶ **States** and **NAIC** drove policy-setting and supervision.
- ▶ Capital requirements calculated at level of **legal entity only**.
- ▶ **No Federal** element
- ▶ International debate centered on whether European authorities would give US system “**equivalence**” under Solvency II.
- ▶ Process was in **stalemate**.

Post-financial crisis

- ▶ Dodd-Frank Act (DFA) created **FIO** – not a regulator, but able to comment on the US regulatory agenda; plays an active role in international policy-setting.
- ▶ DFA created **FSOC** and gave it power to designate non-banks systemically important. The Fed will regulate those designated as such as the group level, and the states will regulate them at the entity level.
- ▶ The **Fed** assumed oversight responsibilities of insurance companies with savings and loan holding companies (SHLCs).
- ▶ **FSB** has increased focus on insurance and designated nine globally systemically important insurers (GSIs)
- ▶ **IAIS** pushing a common supervisory framework (ComFrame) for Internationally Active Insurance Groups (IAIGs)
- ▶ **NAIC** remains key standard-setter and introduced guidelines for insurers to submit an Own Risk and Solvency Assessment (ORSA) starting in 2015.
- ▶ Work is underway at both the Fed and internationally (IAIS) to **develop group-wide** capital standards for certain larger insurers (SIFIs, IAIGs, SLHCs).

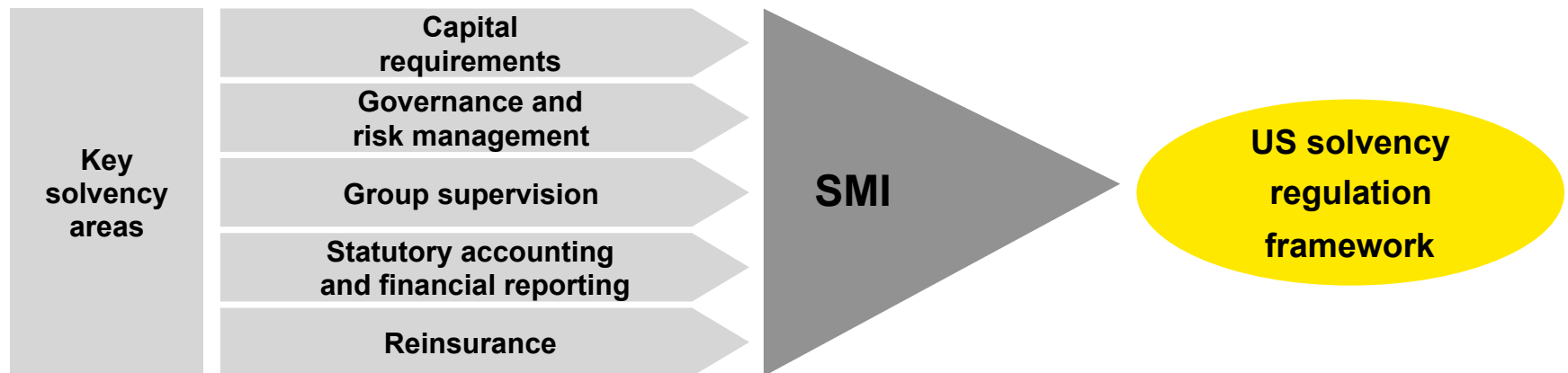
State regulation



State regulation

Overview

- ▶ All US insurers are subject to regulation by the insurance state department in the state domicile.
 - ▶ The National Association of Insurance Commissioners (NAIC) serves as the standard-setting and regulatory support organization.
 - ▶ Each state decides whether or not to pass each model law/regulation
 - ▶ NAIC uses a Risk-based Capital (RBC) framework that uses a mostly formulaic approach to setting minimum capital standards for US insurers on an annual basis.
- ▶ In 2008, the NAIC began the Solvency Modernization Initiative (SMI).
 - ▶ It is a critical self-examination of the US insurance solvency framework.
 - ▶ International developments, banking supervision and international accounting standards
 - ▶ The SMI highlighted the strengths of the state-based system of insurance regulations and several identified potential enhancements were considered



State regulation

Own Risk and Solvency Assessment (ORSA)

- ▶ As part of the SMI, the NAIC voted to adopt ORSA for US regulation.
- ▶ NAIC defines ORSA as *“an internal assessment conducted by the insurer of the material and relevant risks associated with an insurer’s current business plan and the sufficiency of capital resources to support those risks.”*

NAIC primary goals for ORSA

- ▶ To foster an effective level of enterprise risk management (ERM) at all insurance companies through which each identifies, monitors, prioritizes and reports on its material and relevant risks
- ▶ To provide a group level perspective on risk and capital as a supplement to the existing legal entity view

Risk management framework

- ▶ Risk culture & governance
- ▶ Risk identification & prioritization
- ▶ Risk appetite, tolerance & limits
- ▶ Risk management & controls
- ▶ Risk reporting & communication

Quantitative measurements of risk exposure

- ▶ Methodology used to assess all key risks, whether quantifiable or not, across a range of outcomes
- ▶ Both individual and aggregate basis
- ▶ Under normal and stress conditions

Group risk capital and prospective solvency assessment

- ▶ Calculation of group risk capital
- ▶ forward-looking projections based on three- to five-year business plans

State regulation

Latest developments

▶ ORSA

- ▶ Starting in 2015, the NAIC will require an ORSA report (about 30 states have adopted the ORSA Model Act).
- ▶ It applies to individual US insurers that write over \$500 million of gross premium, and/or insurance groups that collectively write over \$1 billion of gross premium

▶ Captive reinsurance

- ▶ Actuarial guidance (i.e., AG 48) was adopted December 2014 for new XXX/AXXX reserve financing transactions through captive arrangements.
- ▶ NAIC adopted revisions to its accreditation program in May 2015 to include regulation of captive insurers and special-purpose vehicles (SPVs) that assume XXX or AXXX business, variable annuities and long-term-care business.

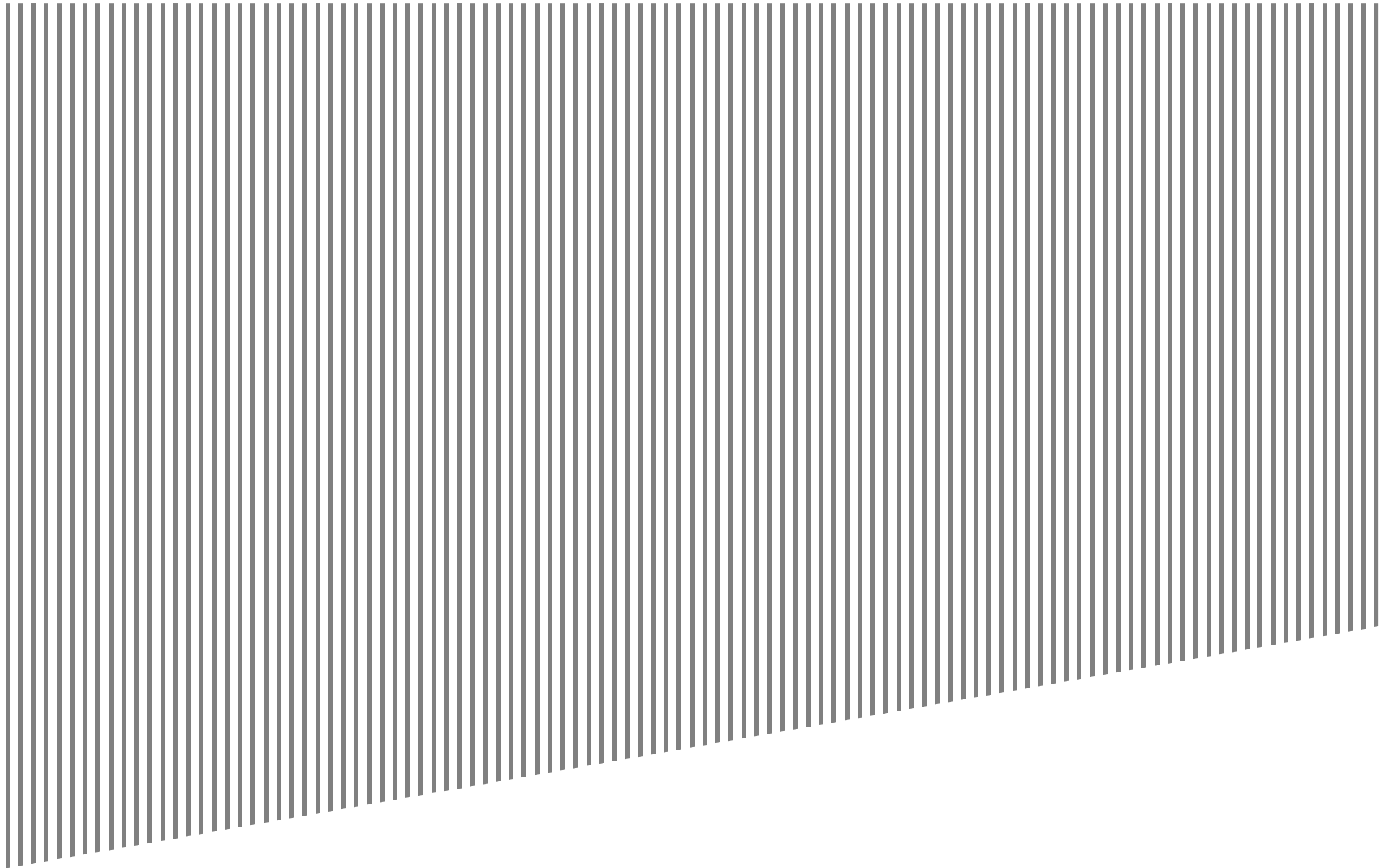
▶ Risk-based capital (RBC) updates are in development for operational risk, catastrophic risk and bond factors.

▶ Principles-based reserving (PBR) for life insurance contracts:

- ▶ The adoption of PBR is expected to be effective January 2017.
- ▶ It requires 42 states with at least 75% of subject premium to have adopted the revised law to become effective.

▶ In April 2015, the NAIC adopted “Principles for Effective Cybersecurity Insurance Regulatory Guidance.”

Federal regulation



Federal regulation

Governing bodies

- ▶ The Federal Reserve (Fed)
 - ▶ Responsible for the supervision of insurance groups designated as systematically important financial institutions (SIFIs) and savings and loan holding companies (SLHCs) under the Dodd-Frank Act.
 - ▶ Oversees 3 non-bank SIFIs (Prudential, MetLife and AIG) and 14 SLHCs (e.g., “TIAA-CREF”)
 - ▶ Subjects SIFI-designated companies are subject to enhanced prudential standards under Dodd-Frank
 - ▶ Currently drafting federal guidelines for designated non-bank SIFIs under supervision, including valuation and capital standards to support consolidated group supervision
- ▶ The Federal Insurance Office (FIO)
 - ▶ Established under Dodd-Frank but not a regulator or supervisor
 - ▶ Responsible for providing expertise and advice on insurance matters to the Treasury Department and other federal agencies
 - ▶ Coordinates closely with the NAIC as an information resource for the Federal Government
- ▶ The Federal Stability Oversight Council (FSOC)
 - ▶ Also established under Dodd-Frank
 - ▶ Responsible for monitoring the safety and stability of the nation’s financial system, identifying risks to the system, and coordinating response to any threats
 - ▶ Responsible for the identification and designation of SIFIs

Federal regulation

Comprehensive Capital Analysis and Review

- ▶ Comprehensive Capital Analysis and Review (CCAR) is a set of requirements used by the regulators to oversee bank and non-bank SIFIs' capital adequacy, capital distribution and capital planning process under various base and stress economic scenarios.
- ▶ Key features of CCAR include annual enterprise-wide stress testing and development of a capital plan.
- ▶ The Fed may object to a capital plan is based on both quantitative (i.e., meeting minimum post-stress regulatory capital ratios) or qualitative (i.e., robust and sound capital planning process) grounds.
- ▶ There are significant ramifications to an Fed objection, including restrictions to capital distributions.

CCAR features for bank holding companies (BHC) SIFIs*

- ▶ Detailed income statement and balance sheet modeling/projections (Nine quarters)
- ▶ Projected capital ratios (nine quarters)
- ▶ three Fed-specified scenarios and 2 internal scenarios at year-end
- ▶ Three internal midyear scenarios
- ▶ Global market shock scenario
- ▶ Counterparty default scenario

- ▶ Board-approved capital plan/capital policy
- ▶ Extensive capital plan supporting documentation (~1,000 pages)
- ▶ Capital plan/capital policy submission to the Fed
- ▶ Required Fed approval of any proposed capital actions



- ▶ Comprehensive stress-testing framework, documentation and model validation
- ▶ Board-reviewed stress-testing results
- ▶ Stress-testing results submission to the Fed
- ▶ Disclosure of stress-testing results by Fed
- ▶ Disclosure of stress-testing result by Firm
- ▶ Granular regulatory reporting templates summarizing actual and forecasted stress income statement and balance sheet results
- ▶ Fed-mandated data quality checks

*CCAR requirements have not been finalized for non-bank SIFIs.

Recovery & Resolution Planning (RRP)

- ▶ RRP (also known as “living wills”) have two components:
 1. *Recovery Planning* – how does a company recover and get “back on track” following a distressed situation
 2. *Resolution Planning* – how does a company who needs to be wound up do so in a way that will not disrupt the financial system
- ▶ All US SIFIs have been are required to submit their RRP to the Fed
- ▶ AIG and Prudential submitted theirs in July 2014
- ▶ MetLife delayed until 2016 as they fight their SIFI designation in the courts
- ▶ Last week Fed responded with first round of feedback to AIG and Prudential:
 - ▶ Said plans lacked detailed information and analysis regarding obstacles to resolvability
 - ▶ These include global cooperation, interconnectedness, adequate funding and liquidity
 - ▶ Instructed the insurers to outline the steps remaining to be more resolvable

Federal regulation

Supervisory & Regulation (SR) letters

- ▶ Fed issue “Supervisory & Regulation” (SR) letters to address significant policy and procedural matters related to the Fed’s supervisory responsibilities.
- ▶ To date over 130 SR letters been produced.
- ▶ Most important to insurance regulation thus far is “SR11-7” which covers Model Risk Management.
 - ▶ ...this lays out the framework for any **model validation** work that is done for any of the Fed regulated firms (SLHCs as well as SIFIs).
- ▶ SR11-7 covers:
 - a) Model Development, Implementation, and Use
 - b) Model Validation, including:
 - ▶ *Evaluation of Conceptual Soundness*
 - ▶ *Ongoing Monitoring*
 - ▶ *Outcomes Analysis*
 - c) Governance, Policies, and Controls

Federal regulation

Latest developments

▶ MetLife

- ▶ December 18, 2014: Designated as a non-bank SIFI by FSOC, subjecting the company to supervision by the Fed
- ▶ January 13, 2015: Filed an action in the US District Court for the District of Columbia to overturn the FSOC's designation of the company as a non-bank SIFI

▶ Insurance Capital Standards Clarification Act of 2014

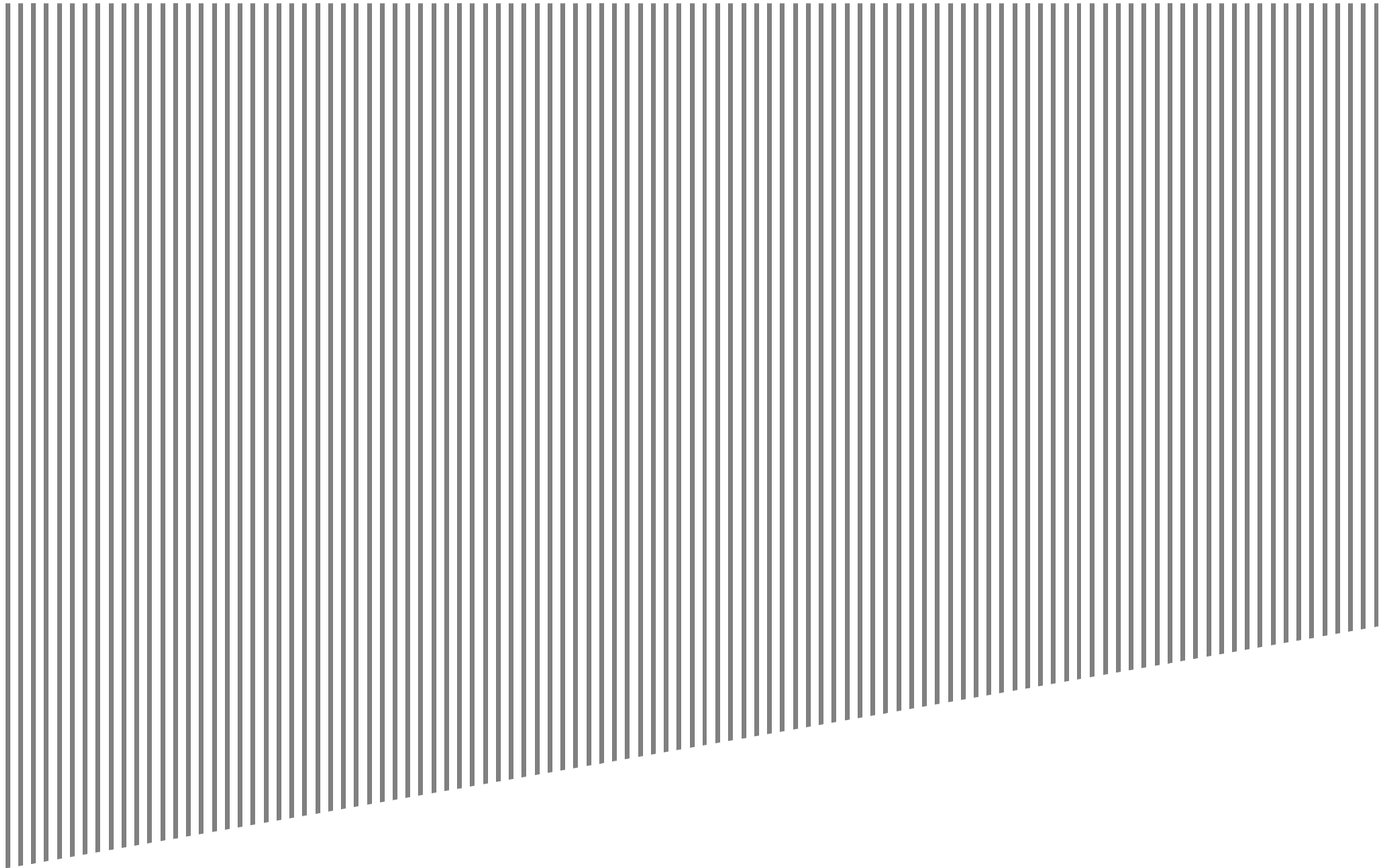
- ▶ December 18, 2014: Bill passed late last year by Congress to amend Dodd-Frank allowing the Fed to craft capital standards tailored for insurers rather than banks

▶ Financial Regulatory Improvement Act of 2015

- ▶ May 2015: The Senate Banking Committee introduced a draft bill aimed to:
 1. Improve transparency over the FSOC SIFI designation process
 2. Establish a process for non-bank SIFIs to shed the designation
 3. Maintain insurance consumer protections under Dodd-Frank
 4. Ensure federal agencies and state regulators work together and reach a consensus on positions for international negotiations

- ▶ June 2015: FSOC releases guidance providing additional details on the initial SIFI designation process

International regulation



International regulation

Governing bodies

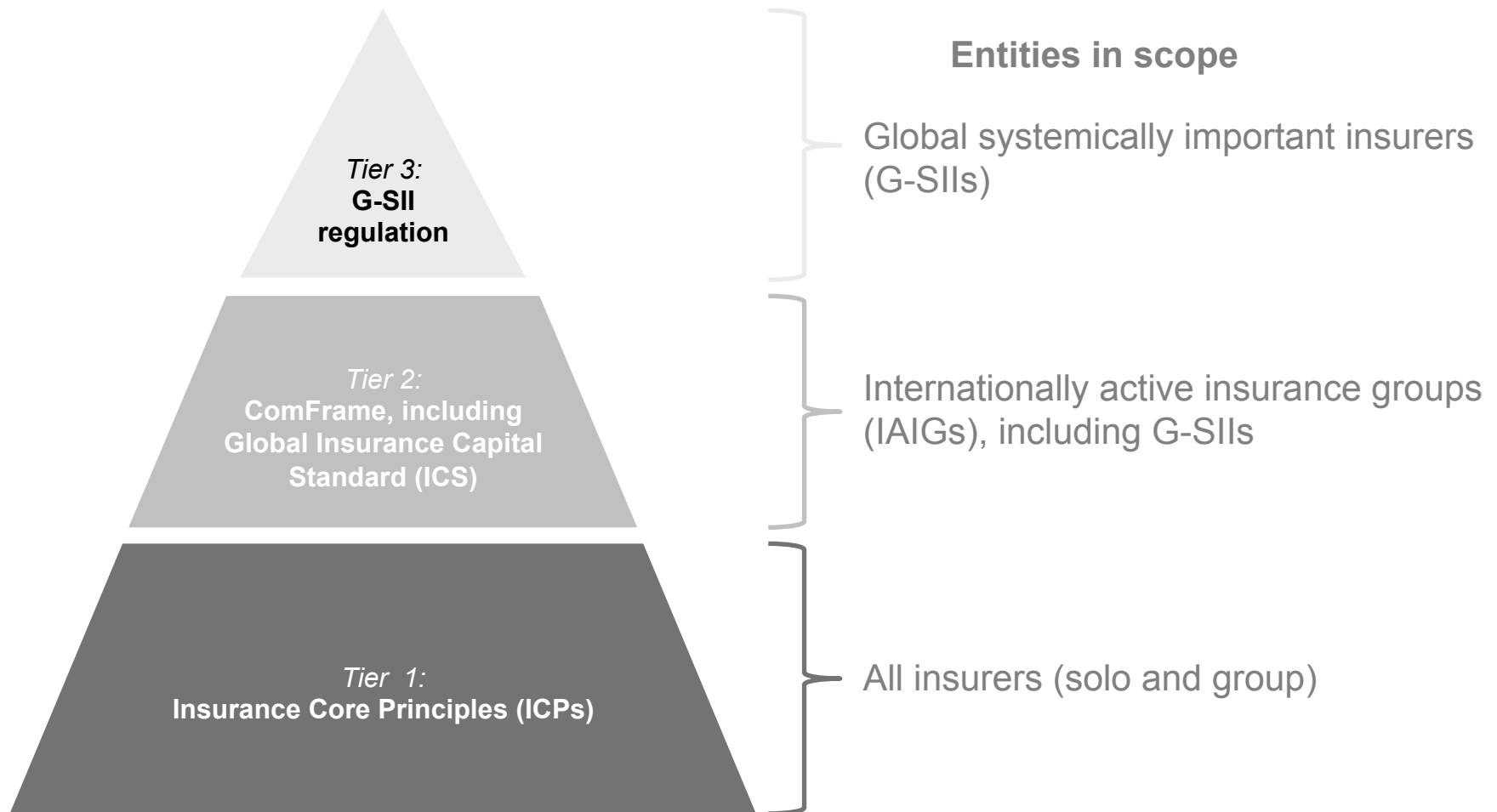
- ▶ The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system.
 - ▶ Established in 2009 by the Group of 20 (G20) leading economies to fortify the global financial system
 - ▶ Promotes international financial stability by coordinating national financial authorities and international standard-setting bodies as they work toward developing strong regulatory, supervisory and other financial sector policies
 - ▶ Includes the Fed as a member
- ▶ The International Association of Insurance Supervisors (IAIS) is a voluntary membership organization of insurance supervisors and regulators from more than 200 jurisdictions in nearly than 140 countries.
 - ▶ Issues global insurance principles, standards and guidance
 - ▶ Also provides supervisory training and support.
 - ▶ Includes the Fed, FIO, NAIC and state regulators as members
 - ▶ Is a member of the FSB

The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

International regulation

IAIS proposed regulatory framework

The IAIS is proposing a three-tiered global regulatory framework:

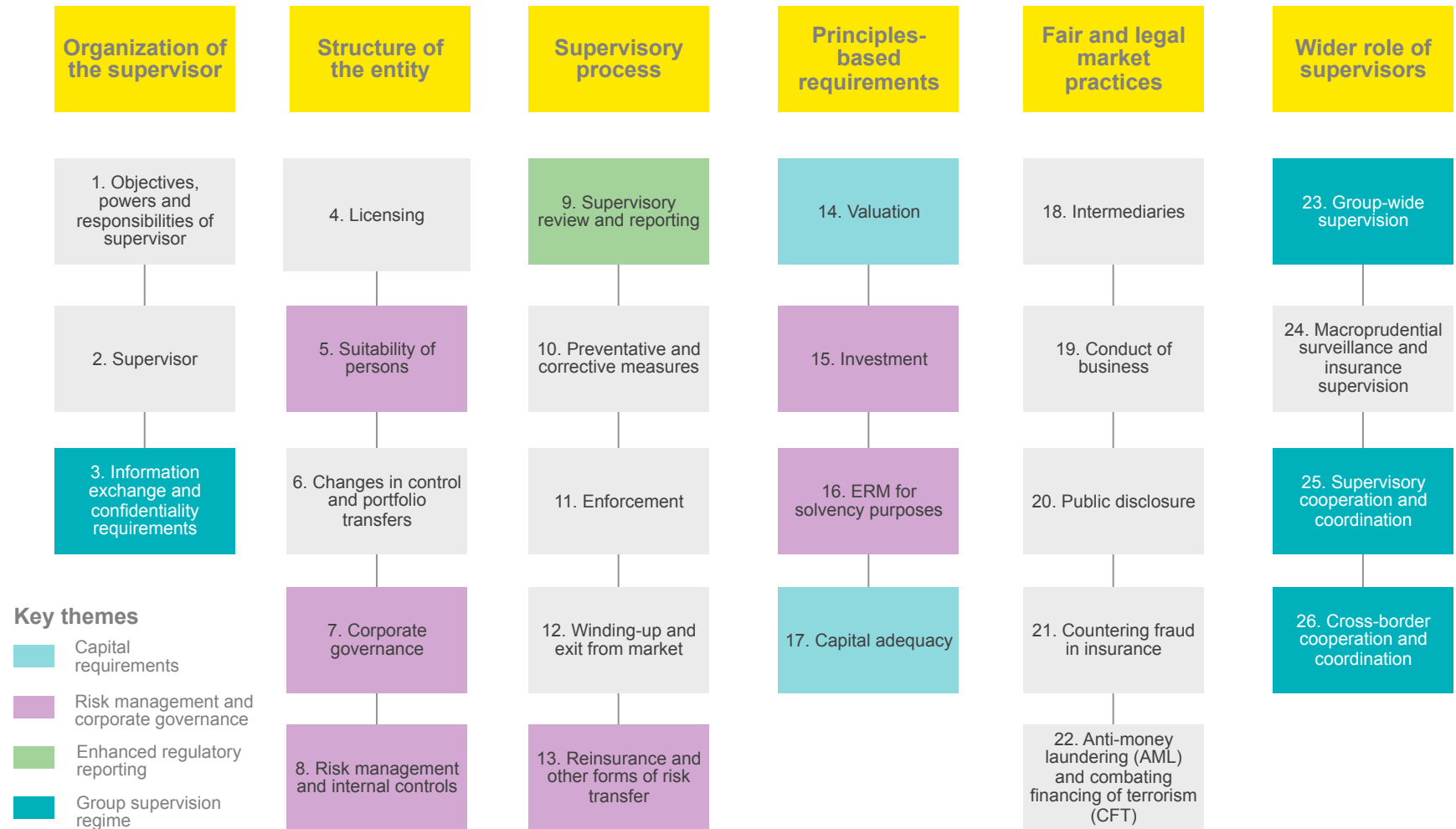


IAIS Tier 1: Insurance Core Principles (ICPs)

- ▶ They are an internationally developed set of **26 core principles** applicable to insurance regulation.
- ▶ They seek to foster convergence toward a “*globally accepted framework for the supervision of the insurance sector*”
- ▶ Current set of ICPs were adopted in October 2011.
- ▶ ICPs have a number of uses:
 - ▶ Serve as a basic benchmark for insurance supervisors in all jurisdictions
 - ▶ Can be used when establishing a supervisory regime
 - ▶ Serve as a framework for identifying areas in existing regimes that need to be improved
 - ▶ Aid evaluation of supervisory regimes in FSAP assessment (World Bank and IMF)

International regulation

IAIS Tier 1: ICP structure – selected themes



International regulation

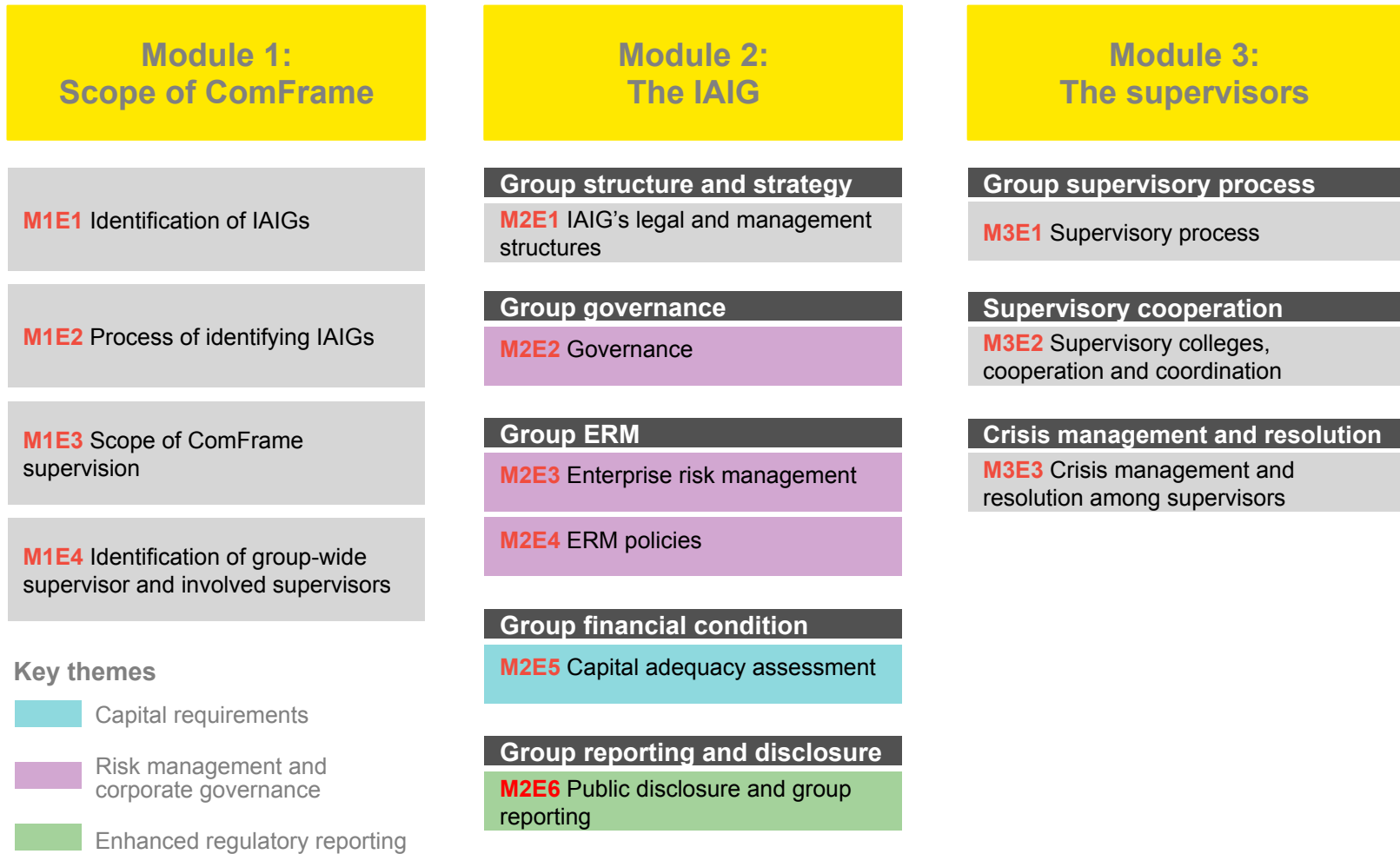
IAIS Tier 2: ComFrame

“Common framework for the group-wide supervision of internationally active insurance groups (IAIGs)”

- ▶ ComFrame builds on and expands upon the ICPs at a **group-wide** level.
- ▶ It includes requirements for both companies (IAIGs) and for national regulators.
- ▶ Scheduled to be formally adopted in 2018. The latest draft version was released at the end of 2013.
- ▶ The development of the new global Insurance Capital Standard (ICS) is expected to have the biggest impact:
 - ▶ It is intended to improve comparability of IAIGs.
 - ▶ *Field testing and impact assessments are currently underway.*

International regulation

IAIS Tier 2: ComFrame structure



International regulation

IAIS Tier 3: G-SII regulation

- ▶ The global financial crisis highlighted the financial world's interconnectivity and the economic risks associated with the failure of a single entity (“**too big to fail**”).
- ▶ It identified the need to **act proactively** and to rapidly identify institutions in distress, subjecting them to orderly resolution if necessary.
- ▶ IAIS, along with the FSB and G20, proposed a framework to provide:
 - i. **Designation** of global systemically important insurers (G-SIIs)
 - ii. **Policy measures** for the supervision of such entities with the objective of reducing moral hazard and systemic risk. Policy measures include:
 - ▶ Capital buffers, such as high loss absorbency (HLA) requirements
 - ▶ System risk management, capital management and crisis management plans
 - ▶ Recovery and Resolution Plans (RRPs)

International regulation

IAIS Tier 3: G-SII designations

- ▶ The FSB designated these nine insurers as G-SIIs in July 2013:

US	Europe	Other
AIG	Allianz (Germany)	Ping An (China)
MetLife	Aviva (UK)	
Prudential Financial	AXA (France)	
	Generali (Italy)	
	Prudential (UK)	

- ▶ G-SIIs will be updated annually based on an assessment by the IAIS.
- ▶ The assessment methodology is currently being updated to appropriately address all types of insurance and reinsurance and other financial activities of global insurers.

Link back to US SIFIs:

- ▶ **MetLife, AIG** and **Prudential Financial** have also been designated as US non-bank SIFIs by the FSOC and are subject to Fed supervision.

International regulation

Global capital standard

- ▶ The IAIS has employed a three-step approach to develop group-wide global capital standards:
 - ▶ Step 1: Develop Basic Capital Requirements (BCR) for G-SIIs
 - ▶ Completed October 2014
 - ▶ Step 2: Develop Higher Loss Absorbency (HLA) requirements to apply to G-SIIs
 - ▶ Additional capital buffer for G-SIIs
 - ▶ Due to be completed by the end of 2015
 - ▶ Will build on the BCR and address additional capital requirements for G-SIIs reflecting their systemic importance in the international financial system
 - ▶ Step 3: Develop a risk-based, group-wide global Insurance Capital Standard (ICS) for IAIGs
 - ▶ Due to be completed by the middle of 2017 (version 1.0) and updated in 2019 (version 2.0) after revisions and further field testing
- ▶ ICS will not replace existing arrangements or capital standards for legal entity supervision.

International regulation

ICS proposal – valuation approach

- ▶ In December 2014, the IAIS released a draft ICS proposal for consultation/public comment.
 - ▶ Included two valuation approaches: Market-adjusted and GAAP-plus-adjustments
- ▶ Market-adjusted approach – standard method proposal
 - ▶ Requires prescribed adjustments to be made to jurisdictional GAAP accounting valuations
 - ▶ Adjustments include:
 - ▶ A common margin over current estimates (MOCE) for insurance liabilities
 - ▶ Discounting cash flow using an IAIS-prescribed yield curve
 - ▶ Prescribed approaches to contract boundaries, valuation of options and guarantees, and discretionary benefits
 - ▶ Fair value of invested assets
- ▶ GAAP-plus-adjustments approach (GAAP+)
 - ▶ It is based on existing rules in individual jurisdictions where an IAIG is domiciled.
 - ▶ Assets and liabilities are reported under existing accounting rules in jurisdiction.
 - ▶ Adjustments are expected to recognize the long duration nature of certain assets and liabilities such that market volatility is minimized.

International regulation

ICS proposal – US implications

- ▶ Market-adjusted approach
 - ▶ Unpopular with US insurers
 - ▶ 2014 field testing resulted in poor results for spread-based products
- ▶ Capital requirements risk measure
 - ▶ A VaR/Tail-VaR risk measure with a limited time horizon (e.g., one year) may not be appropriate for life business
- ▶ Other considerations
 - ▶ Policyholder behavior and recognition of risks related to embedded options and guarantees
 - ▶ Investment in infrastructure
 - ▶ Discounting non-life liabilities

International regulation

ICS issues

- ▶ “One size fits all” valuation approach
 - ▶ The valuation approach used to measure assets and liabilities remains a major point of contention.
 - ▶ The market valuation approach is favored by Europeans because it is very similar to Solvency II.
 - ▶ US authorities instead are favoring the GAAP+ approach.
 - ▶ IAIS is currently exploring the possibility of developing a GAAP+ approach in addition to the standard market value approach.
- ▶ Implementation timing
 - ▶ Many key stakeholders feel the timeline the IAIS set for itself to design and construct an ICS is too aggressive.
- ▶ Transparency
 - ▶ IAIS has limited the number of interested parties who can attend regulatory meetings, which has drawn criticism from US insurers and regulators.

International regulation

Latest developments

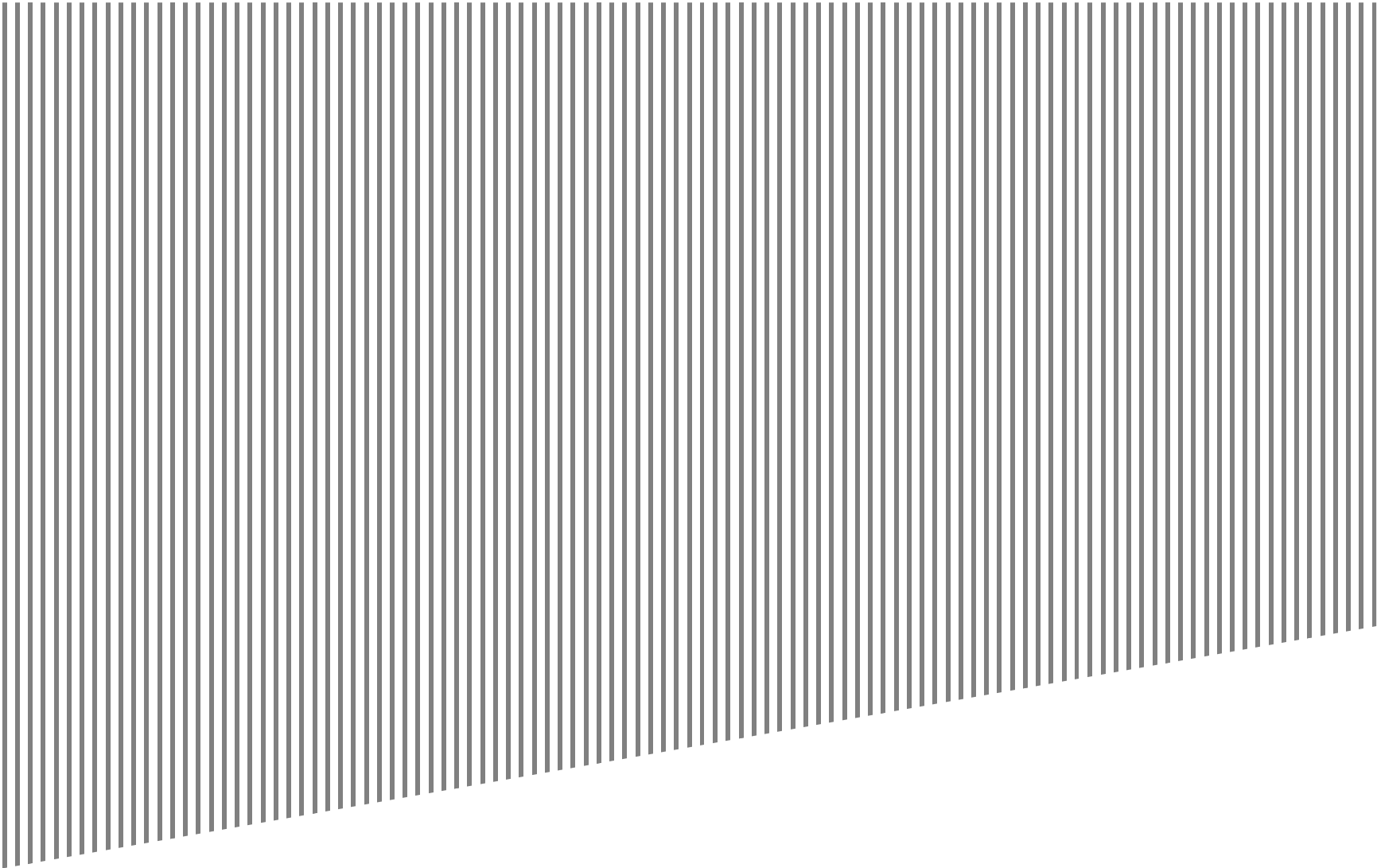
▶ ICS

- ▶ December 2014 – IAIS releases a draft ICS proposal.
 - ▶ Consultation for public comments closed February 2015.
 - ▶ Field testing conducted between April and June 2015.
- ▶ June 2015 – IAIS postpones the adoption of ICS.
 - ▶ ICS version 1.0 delayed until May-June 2017:
 - ▶ Will be used for field testing and confidential reporting
 - ▶ Will allow insurers to use two valuation approaches – market-adjusted or GAAP+
 - ▶ ICS version 2.0 delayed one year to 2019.
 - ▶ Final version – TBD
 - ▶ *“After ICS version 2.0 is adopted there will be an implementation period while jurisdictions embed the ICS into regulatory requirements and supervisory practices. ... During a period of implementation monitoring by the IAIS, lessons will undoubtedly be learned and used as progress is made along the path of convergence for future milestones.” – IAIS*

▶ HLA

- ▶ June 2015 – IAIS released an HLA consultation paper describing scope and structure of the measure.
 - ▶ Consultation ends August 2015, and HLA will be finalized by the end of 2015.

Overview of US regulation



Overview of US regulation

The “players”

National Association of Insurance Commissioners (NAIC)

- ▶ Association of state insurance regulators.
- ▶ Develops model standards for individual states to (possibly) adopt
- ▶ Runs Accreditation Program to maintain minimum standards across all states

Federal Insurance Office (FIO)

- ▶ Established under Dodd-Frank to:
 - ▶ Monitor all aspects of the insurance sector
 - ▶ Represent the US on prudential aspects of international insurance matters
- ▶ Has no direct regulatory powers

International Association of Insurance Commissioners (IAIS)

- ▶ Voluntary membership organization of insurance regulators from over 200 jurisdictions
- ▶ Issues global insurance principles, standards and guidance; also provides supervisory training and support

“Team USA”

Federal Reserve Board (Fed)

- ▶ Dodd-Frank authorized the Fed to supervise insurers designated as non-bank SIFIs, as well as those entities with savings and loan holding companies
- ▶ Groups supervised by the Fed hold approximately one-third of US industry assets

Financial Stability and Oversight Council (FSOC)

- ▶ Established under Dodd-Frank to identify and respond to risks to US financial stability
- ▶ Responsible for designating insurers as US domestic SIFIs

Financial Stability Board (FSB)

- ▶ An international body that monitors and makes recommendations about the global financial systems
- ▶ Responsible for designating insurers as globally systemic important (G-SII)

International

Overview of US regulation

Company designations

US designations

US non-bank SIFIs (*Systematically Important Financial Institutions*)

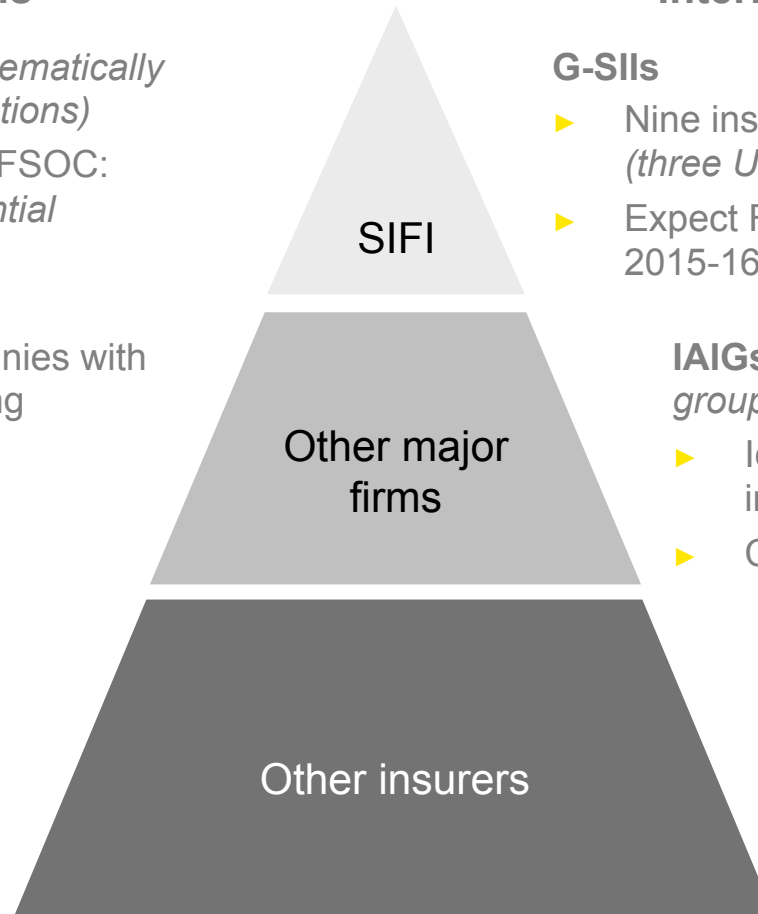
- ▶ Three designated by FSOC:
AIG, MetLife, Prudential*

SLHCs (*Insurance companies with Savings and Loans Holding Companies*)

- ▶ 14 in the US

Other insurers

- ▶ Largely solo-entity level, some group



International designations (IAIS)

G-SIFs

- ▶ Nine insurers designated by the FSB thus far (*three US firms: AIG, MetLife, Prudential*)
- ▶ Expect FSB to designate G-SII reinsurers in 2015-16

IAIGs (*internationally Active Insurance groups*)

- ▶ Identification depends on size and international activity
- ▶ Could affect ~50 insurers globally

Other insurers

- ▶ Solo and group

* *MetLife is litigating against the FSOC SIFI designation.*

Overview of US regulation

Designation implications

US designations

International designations (IAIS)

US non-bank SIFIs

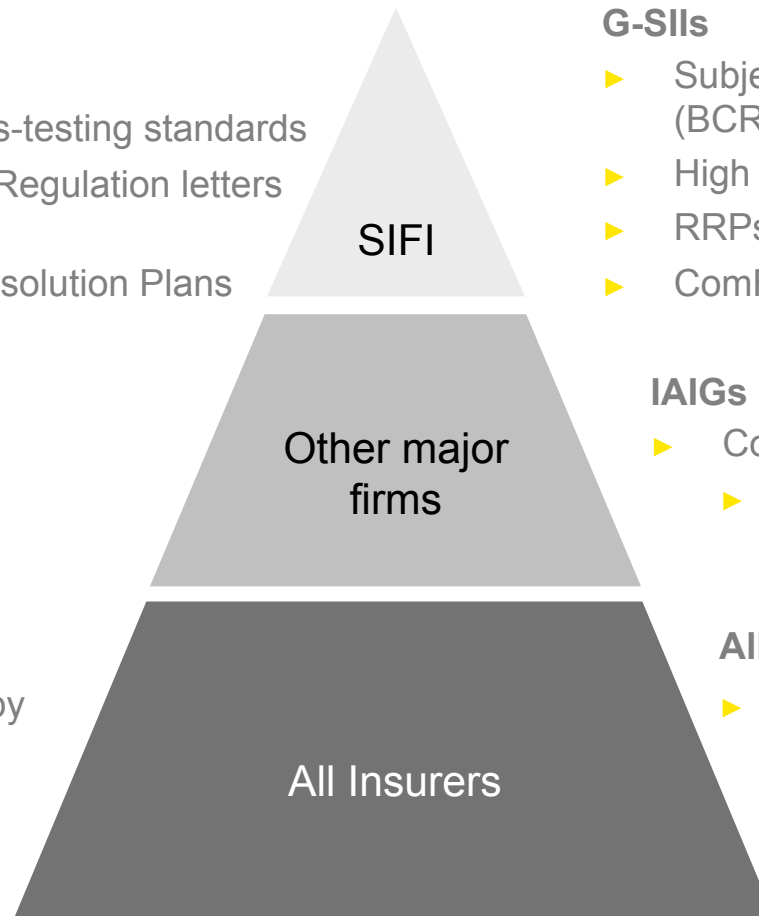
- ▶ Fed supervision
 - ▶ Capital and stress-testing standards
 - ▶ Supervisory and Regulation letters (SR letters)
 - ▶ Recovery and Resolution Plans (RRPs)

SLHCs

- ▶ Fed supervision
 - ▶ SR letters

All insurers

- ▶ Subject to regulation by the individual states
- ▶ US regulation largely observes IAIS ICPs



G-SIFIs

- ▶ Subject to Basic Capital Requirement (BCR) / ICS
- ▶ High Loss Absorbency (HLA) requirements
- ▶ RRP
- ▶ ComFrame

IAIGs

- ▶ ComFrame
- ▶ International Capital Standard (ICS)

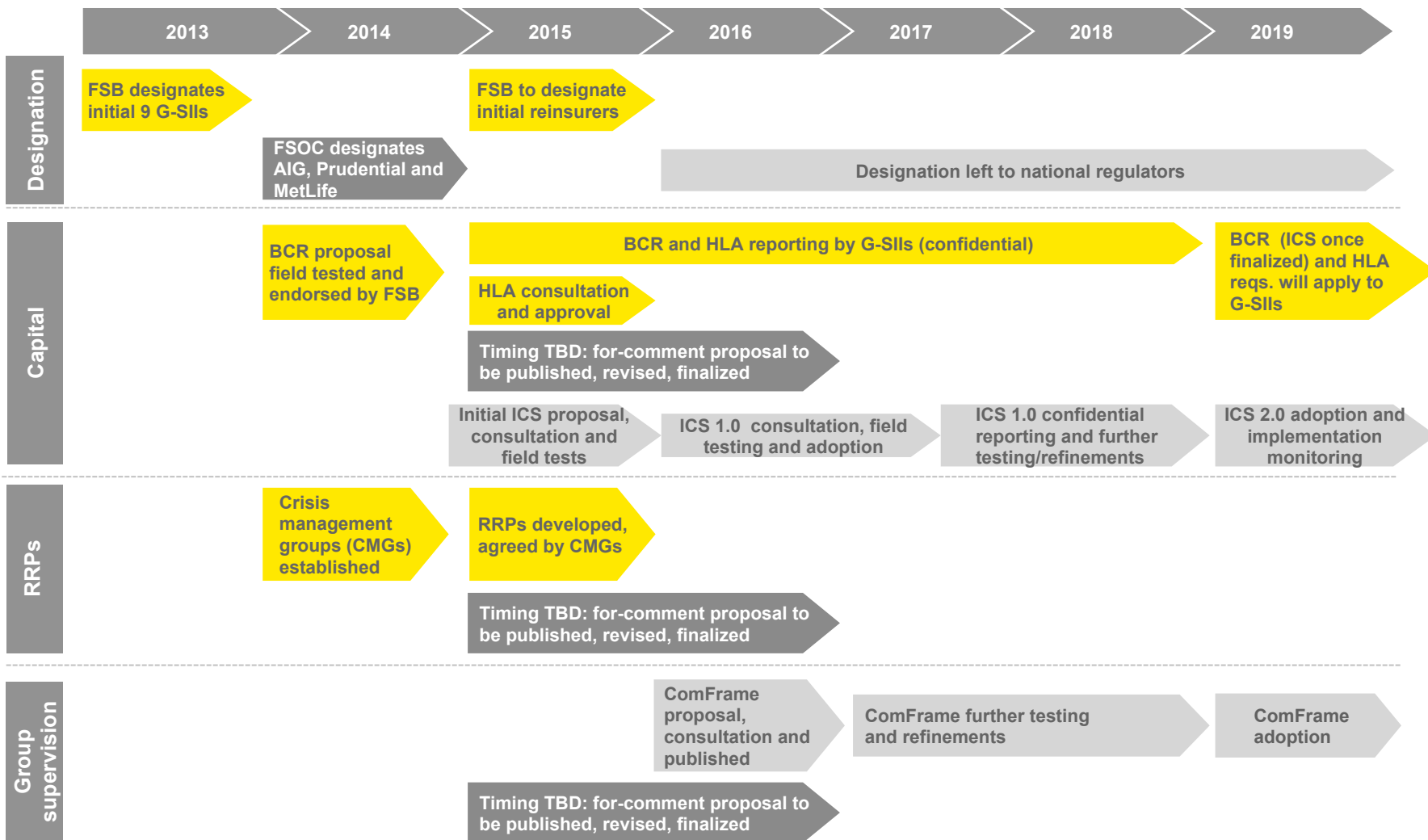
All insurers

- ▶ Insurance Core Principles (ICPs)

Regulatory timelines

There are overlapping efforts to develop new regulations

G-SIIs
IAIGs
US SIFIs



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