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2015 SEAC Annual Meeting

Regulatory Alphabet Soup

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Agenda

1. Trending regulatory topics & themes
2. The IAIS
3. The Federal regulatory system
4. The NAIC
5. Comparisons and implications
6. Sources and Useful links

Trending regulatory topics & themes

Regulatory landscape overview

Trending industry regulatory themes

Group-wide Supervision	• ORSA has group-wide assessments reported to domicile regulator • EU & IAIS has "Supervisory colleges" for IAIGs • FRB has oversight over 1/3rd of life industry • New risk based group wide insurance capital standards
Developing Trends	• Culture of risk awareness and oversight • Multitude of regulators • Focus on risk management and impact to broader markets • Stance that groups should be source of capital strength to entities
Systemic Risk Analysis	• Focus on "nontraditional" products and activity (e.g., VA, GIC) • Stress testing • Increased regulatory reporting • Capital planning and capital adequacy management • Recovery and resolution planning

Trending U.S. regulatory topics

- SIFI designations issued by FSOC
- Enhanced Prudential Standards being developed by the Federal Reserve
- US ORSA requiring stress testing and financial modelling
- RBC Aggregation/SAP Consolidated Filing for RBC/GAAP Consolidated Filing for RBC approach under consideration to utilize as a insurance group capital assessment for US IAIGs
- "Team USA" collaboration on the global stage

The IAIS

IAIS – Who, Why?

- IAIS represents insurance regulators and supervisors from more than 200 jurisdictions, including the NAIC and FIO.
- The IAIS works closely with other financial sector standard setting bodies and international organizations to promote financial stability.

The objectives of the Association are to:

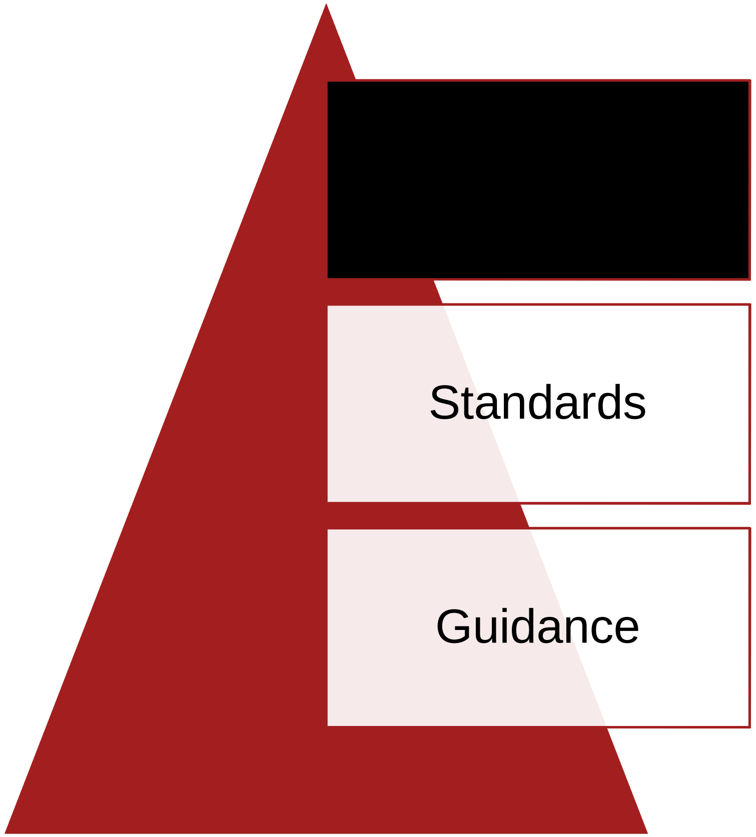
- Promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and
- Contribute to global financial stability.

The IAIS is a member of the Financial Stability Board (FSB) and is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues.

IAIS insurance core principles

The 26 ICPs cover both macro-prudential matters and policyholder protection and are organized in a hierarchy. Selected titles below.

2: Supervisor	8: Risk Mgmt & Internal Controls
15: Investment	14: Valuation
16: ERM for Solvency	7: Corporate Governance
5: Suitability of Persons	23: Group-wide Supervision
19: Conduct of Business	24: Public Disclosure



IAIS – ComFrame

Group-wide	• Make group supervision more effective • Internationally Active Insurance Groups
Framework	• Establish a framework for supervisors to address group wide activities and risks • Set grounds for better supervisory cooperation
Convergence	• Foster global regulatory convergence

Who are the G-SIIs and IAIGs?

The 9 designated Global Systemically Important Insurers (G-SIIs) include:

- **AIG, Prudential Financial, MetLife, AXA, Allianz, Prudential PLC, Aviva, Ping An & Aegon**

While not formally designated yet, criteria for being considered an Internationally Active Insurance Groups (IAIG):

- Must include at least one sizeable insurance entity
- Must include both proposed international activity criteria:
  - Premiums are written in not fewer than three jurisdictions
  - Percentage of gross premiums written outside the home jurisdiction is not less than 10% of the group's total gross written premium
- Must meet at least one of the size criteria:
  - Total assets of not less than USD 50 Billion
  - Gross written premiums of not less than USD 10 Billion

In addition to the G-SIIs, examples of other insurers that meet the IAIG criteria:

- **Ace Ltd, Chubb, SCOR, Swiss Re, Zurich Insurance Group**

Basic capital requirement

19. As a formula, the BCR Required Capital is:

$$BCR\ Required\ Capital = \alpha\left[\sum_{i=1}^{4} a_i\,TL_i + \sum_{i=1}^{4} b_i\,TNL_i + \sum_{i=1}^{4} c_i\,NT_i + \sum_{i=1}^{3} d_i\,A_i\right] + \sum_{i=1}^{n} NI_i$$

where:

- *α (alpha) is the scalar to adjust the overall BCR level and potentially target a specified confidence level*
- *ai, bi ci and di represent the factors applied to the exposures.*
- *TLi, TNLi, NTi, and Ai represent the exposures (as per section 3.4)*
- *NI reflects the charges provided by sectoral rules for non-insurance activities (for example Basel Accord requirements)*

BCR segment	Proxy measure for risk exposure	Factor	Factor value
Traditional Life (TL)			
Protection life	Net Amount At Risk	a_1	0.056%
Participating products	Current Estimate	a_2	0.6%
Annuities	Current Estimate	a_3	1.2%
Other life	Current Estimate	a_4	0.6%
Traditional Non-life (TNL)			
Property	Premium	b_1	6.25%
Motor	Current Estimate	b_2	6.25%
Casualty	Current Estimate	b_3	11.25%
Other non-life	Current Estimate	b_4	7.5%
Non-Traditional (NT)			
Variable annuities	Notional Value	c_1	1.2%
Mortgage insurance	Face Amount	c_2	1.11%
GICS & Synthetic GICS	Notional Value	c_3	1.11%
Other non-traditional	Current Estimate	c_4	1.29%
Assets (A)			
Credit - investment grade	Fair Value	d_1	0.69%
Credit - non investment grade	Fair Value	d_2	1.8%
Equity	Fair Value	d_3	8.4%

ICS principles

- Dual objectives – Policyholder protection and financial security
- For GSIIs and IAIGs
- ICS is the foundation for HLA for G-SIIs
- Reflects all material risks
- Comparability of outcomes
- Promotes sound risk management
- Minimize inappropriate procyclical behavior
- Strike balance between risk sensitivity and simplicity
- Transparency
- Capital requirement is based on appropriate target criteria

Federal regulatory system

Dodd-Frank impact on insurance

Financial Stability Oversight Council

Formed July 21, 2011. Headed by Secretary of Treasury, but technically not a subsidiary of the Department of Treasury. Regulates "Systemically Important" Institutions and Recommends Heightened Prudential Standards

Federal Insurance Office

- Monitors all aspects of the insurance industry (except health insurance, some long-term care insurance, and crop insurance).
- Focuses on gaps in regulation that could contribute to systemic risks.
- Recommends to the FSOC insurance companies for regulation as a SIFI.
- Determines if state insurance measures are pre-empted by international agreements.
- Collects, analyzes and shares information on insurance industry and companies amongst federal regulators.
- Coordinates on international issues.

State Insurance Regulators

- Non-bank SIFIs designated by the FSOC
- "Material financial distress"
- "Nature, scope, size, scale, concentration, interconnectedness, or mix of activities"
- Must be "predominantly engaged" in financial activities
- Risk based capital requirements
- Liquidity requirements
- Resolution plan ("living will")
- Credit exposure reporting and concentration limits
- Stress tests
- Possible contingent capital, enhanced public disclosures, short term debt limits
- Incremental regulatory reporting to the Federal Reserve and Office of Financial Research
- Examination by the Federal Reserve

Insurance SIFIs

Insurance Industry

FSOC factors for SIFI designation

In the Rule and Guidance, FSOC created a staged process for identifying and analyzing companies for a potential SIFI designation.

Description	Overview
Stage 1	• Six (6) quantitative thresholds are applied to identify a set of companies that merit further evaluation ("FSOC Stage 1 Thresholds") • Assesses whether a nonbank financial company may be subject to further evaluation by the Council
Stage 2	• A nonbank financial company that meets both the total consolidated assets threshold and any one of the other thresholds is in Stage 2 • The Council will notify a company if the Council commences an active review of the company in Stage 2, yet retains the discretion to consider a company in Stage 2 if the FSOC Stage 1 Thresholds aren't met

FSOC Stage 1 Thresholds

1	$50 billion in total consolidated assets
2	$30 billion in gross notional credit default swaps (CDS) outstanding for which a nonbank financial company is the reference entity
3	$3.5 billion of derivative liabilities
4	$20 billion in total debt outstanding
5	15 to 1 leverage ratio
6	10 percent short-term debt ratio

Total consolidated assets in addition to any of these other outlined thresholds results in Stage 2 FSOC analysis

Comprehensive Capital Adequacy Review ("CCAR")

Supervised BHCs and financial institutions designated as SIFIs are required to submit annual capital plans with detailed descriptions of the following:

- Internal processes for assessing capital adequacy
- Policies governing capital actions such as common stock issuance, dividends, and share repurchases
- Planned capital actions over a time-specific planning horizon
- Results of stress tests conducted under a range of scenarios that assess the sources and uses of capital under baseline and stressed economic and financial conditions ("Dodd-Frank Act Stress Test" or "DFAST")

Comprehensive Capital Adequacy Review ("CCAR")

Seven principles of an effective capital adequacy process (CAP)[1]		
1	**Sound foundational risk management**	The BHC has a sound risk-measurement and risk-management infrastructure that supports the identification, measurement, assessment, and control of all material risks arising from its exposures and business activities.
2	**Effective loss-estimation methodologies**	The BHC has effective processes for translating risk measures into estimates of potential losses over a range of stressful scenarios and environments and for aggregating those estimated losses across the BHC.
3	**Solid resource-estimation methodologies**	The BHC has a clear definition of available capital resources and an effective process for estimating available capital resources (including any projected revenues) over the same range of stressful scenarios and environments used for estimating losses.
4	**Sufficient capital adequacy impact assessment**	The BHC has processes for bringing together estimates of losses and capital resources to assess the combined impact on capital adequacy in relation to the BHC's stated goals for the level and composition of capital.
5	**Comprehensive capital policy and capital planning**	The BHC has a comprehensive capital policy and robust capital planning practices for establishing capital goals, determining appropriate capital levels and composition of capital, making decisions about capital actions, and maintaining capital contingency plans.
6	**Robust internal controls**	The BHC has robust internal controls governing capital adequacy process components, including policies and procedures; change control; model validation and independent review; comprehensive documentation; and review by internal audit.
7	**Effective governance**	The BHC has effective board and senior management oversight of the CAP, including periodic review of the BHC's risk infrastructure and loss- and resource-estimation methodologies; evaluation of capital goals; assessment of the appropriateness of stressful scenarios considered; regular review of any limitations and uncertainties in all aspects of the CAP; and approval of capital decisions.

[1] The Federal Reserve provides further explanation of its expectations for the internal capital planning process at large complex bank holding companies in light of these principles in a publication entitled: *Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice* (August 2013).

CCAR and DFAST comparison

DFAST is complimentary to CCAR – Yet both rely on testing exercises that utilize similar processes, data, supervisory expectations, and requirements.

CCAR	DFAST
• Capital Plan Rule adopted by Federal Reserve in November 2011, and modified in October 2014 • Affecting BHCs with > $50 billion in assets • Currently 31 participants • FBO's with US non-branch assets >$50 billion will form IHC's that become subject to CCAR in 2016/2017 (depends on whether IHC is a re-purposed BHC) • Capital Plans must be approved by the BHC's Board of Directors prior to annual submission to the Fed • Subject to Federal Reserve approval (object/non-object) of capital plan and capital actions • Must maintain > 5% post-stress Tier 1 Common ratio, among other capital ratio minimums • Fed may object based on quantitative or qualitative supervisory assessments	• The Dodd-Frank Act requires the Fed to conduct annual stress tests of BHC's with assets >$50 billion • The Fed first adopted rules implementing these requirements in October 2012 and modified in 2014 • Uses a "stylized" set of capital actions (i.e. extends current dividend rate over planning horizon) • The projections are based on three supervisory macroeconomic scenarios required by the Dodd-Frank Act (baseline, adverse, and severely adverse) • Annual & mid-cycle reviews - January 5th and July 5th – Moving to April and October beginning in the 2016 cycle • No objections, strictly reporting • BHC's with assets between $10-50 billion (often referred to as DFAST banks) are subject to a lighter regulatory touch as it relates to stress testing and capital planning

Recovery and resolution plans

Supervised BHCs and financial institutions designated as SIFIs are required to submit Recovery and Resolution plans:

Description	Recovery plan	Resolution plan
Objective	• *Playbook for recovering the firm from severe systemic or idiosyncratic stress event.* • *Demonstrates the firm's ability to recover based on its financial (capital and liquidity/funding) strengths.*	• *Playbook to resolve the firm once it reaches at a level where it cannot be recovered.* • *Demonstrates the firm's ability to be resolved quickly and effectively without any systemic impact, and its ability to separate and maintain continuity of systemically important functions/activities.*
Situation	• *Going concern (with risk of failure).*	• *Gone concern (insolvency, bankruptcy, receivership).*
Owner/Driver	• *Management/Board.*	• *Regulatory authorities/Board.*
Core, Specific components	• *Stress scenarios.* • *Triggers, escalation and communication.* • *Recovery actions (de-risking and contingency).* • *Results demonstrating recovery from tress.*	• *Resolution strategy and related analysis.* • *Obstacles to resolution and corresponding mitigations.* • *Applicable resolution regimes.* • *Assumptions related to responses from the regulators, market utilities, and customers.*
Common components across recovery and resolution	• *Organisation structure, legal entity structure and the overview of business activities.* • *Identification of core businesses, systemically important operations (critical operations) and material entities that support these businesses and operations.*	• *Interconnectedness and dependencies across core businesses, critical operations and material entities.* • *Obstacles to maintaining critical operations and corresponding mitigations.* • *Plan governance (governance of recovery plan and governance of resolution plan).*
Typical size of the plan	• *250 to 400 pages plus appendices.*	• *1200 – 1500 pages plus appendices.*

Federal capital standard – Considerations

- The Federal Reserve is currently in the information gathering stage for the development of a group federal capital standard for non-bank systemically important financial institutions (SIFIs) that are insurance companies (i.e., covered insurers)
  - *SIFIs: AIG, Prudential, Met Life*
  - *SLHCs: Nationwide, Mutual of Omaha, TIAA-Cref, State Farm, USAA*

- Prudential levels of capital for these groups, focus on financial health not policyholder protection
- The FRB is seeking input from various industry groups
- The capital standard could be GAAP or Statutory based, a combination of both, or based on Cash Flow
- For covered institutions, there will be a stress testing element
- For SLHCs, the focus and scope of the federal capital standard applicability is unclear

The NAIC

The NAIC RM ORSA

The NAIC ORSA Guidance Manual outlines expectations in three distinct sections.

Section 1

Description of the Risk Management Framework

- Risk Culture and Governance
- Risk Identification and Prioritization
- Risk Appetite, Tolerances and Limits
- Risk Management and Controls
- Risk Reporting & Communication

Section 2

Insurer's Assessment of Risk Exposure

- Details on identified risks
- Quantification of major risks
- Outcomes of plausible adverse scenarios
- Impact of stressed environments
- Quantitative & qualitative
- Model validation

Section 3

Group Risk Capital & Prospective Solvency Assessment

- Explains how risk assessment determines financial resources
- Link to business strategy and planning horizon
- Group assessment of Risk Capital
- Prospective Solvency Assessment

NAIC group capital recommendation

- CDAWG – ComFrame Development and Analysis (G) Working Group
- In September 2015, proposed a high level methodology to determine capital for US insurance groups
- In addition, a group capital requirement can assist in:
  - Group capital requirements for ORSAs
  - Form F Filings
  - Identification of risks not captured in the legal entity RBC.

Key Challenges are:

1. Scope & Scalability
2. Non-RBC filers
3. Going vs Gone concern
4. Subordinated Debt treatment
5. Inter-company Eliminations
6. Incorporation of Stress Tests

The recommendation charges the NAIC Financial Condition (E) Committee to develop an RBC Aggregation Methodology and work with the CDAWG and the FRB as needed to further develop the requirements

Comparisons & implications

Comparing the Different Group Capital Proposals

	IAIS – BCR (Round 1)	IAIS – ICS	IAIS – ICS (Round 2)	Federal Capital Standard	NAIC CDAWG
Applies to	G-SIIs	IAIGs	G-SIIs	SIFIs & SLHCs	US Insurance Groups
Status	Final	Under Consideration	ICS to replace BCR	Under Consideration	Proposed
Implements	Confidential 2016	2019	2019	Unknown	Unknown
Model	Factor Model w/ HLA	Internal Model; Stress Tests	Same as ICS w/ HLA	Unknown	Aggregated RBC
Valuation Basis	Market Adjusted	Likely Market Adjusted	Likely Market Adjusted	US GAAP Stat or Cash Flow	Stat

Implications for insurers

Group Capital

- A single group capital standard is unlikely in the short term
- All new proposals have a few years of testing ahead of them
- There could be more pressure for the largest insurers to de-risk

Stress Testing

- Insurers may need to enhance their financial planning and analysis frameworks
- Projection capabilities will need to incorporate enterprise-wide elements

Enterprise Risk Management

- Regulators will expect ERM program to continue to mature
- Model validation will become increasingly important

Sources & useful links

Article in AAA Newsletter, July 2015

http://www.actuary.org/Essential-Elements/insurance-capital-standards

IAIS Website: www.iaisweb.org

Global Systemically Important Insurers: Initial Assessment Methodology, *July 2013*

Insurance Capital Standards Principles, *September 2014*

Basic Capital Requirements for Globally Systemic Important Insurers, *October 2014*

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Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice, *August 2013*

Thank you.

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