NAIC International Insurance Forum

Global Insurance Solutions

As of May 2019

ON MAY 13–14, WE ATTENDED THE 2019 NAIC INTERNATIONAL INSURANCE FORUM IN WASHINGTON, D.C. TO STAY INFORMED ON IMPORTANT REGULATORY ISSUES THAT ARE AFFECTING THE INSURANCE INDUSTRY TODAY. SUMMARIZED IN THIS DOCUMENT ARE THE MOST RELEVANT DISCUSSIONS FROM THE MEETING.

KEY TOPICS (Full details below)

- **U.S. Secretary of Treasury Steven Mnuchin delivers the keynote address, noting how federal and state coordination remains key to advancing the U.S. insurance industry's interests globally:** Treasury Secretary Mnuchin's remarks highlighted the Treasury's support for state-based insurance regulation, and also the important role the federal government has in the policy-making discussions on global insurance issues.
- **A panel of prominent chief executives share their views on what lies ahead for the insurance industry:** The chief executives of AIG, MassMutual, Guardian Life and Hamilton Insurance Group discussed some of the notable opportunities and challenges that loom for their firms, and the industry as a whole.
- **Systemic Risk in the Insurance Sector:** As the International Association of Insurance Supervisors (IAIS) moves towards finalizing the Holistic Framework for systemic risk later this year, panelists discussed expectations around the potential scope and the level of application of the framework's proposed policy measures.

REMARKS FROM THE U.S. TREASURY SECRETARY ON THE INSURANCE SECTOR REGULATION

The keynote address of this year's forum was given by Steven Mnuchin, the U.S. Secretary of Treasury. In his keynote, Mr. Mnuchin highlighted the vital role the insurance sector plays in the U.S. economy and the stability of the U.S. financial system. Mr. Mnuchin also pledged the Treasury's support of the state-based system of insurance regulation. As U.S. insurance companies compete globally and increasingly look overseas for growth opportunities, the Treasury, he noted, also sees an important role for the federal government in the policy-making discussions on global insurance issues.

Mr. Mnuchin then took the time to comment on two topical items that involve global standard setting and the IAIS – the Insurance Capital Standard (ICS) and the development of the 'Holistic Framework' to assess and mitigate systemic risk in the insurance sector.

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Please contact Wheatley Garner, *Investment Accounting and Regulatory Reporting* at wheatley.garner@jpmorgan.com, or our Investment Accounting and Regulatory Reporting team at investment.accounting@jpmorgan.com.

For ICS, three areas of focus and concern were highlighted by Mr. Mnuchin:

First, the Treasury is continuing to work to ensure that the ICS appropriately reflects the unique business model of insurers, in particular, the ICS's market valuation approach[1], and the negative effects it could have on the ability of insurance companies to provide long-term savings products, which are critical to the millions of Americans entering retirement.

Second, the Treasury believes it is important that the IAIS creates a defined structure and process for further work and revisions on the ICS during the monitoring period from 2020 to 2024. Many feel the ICS will need further development and revision during this period, therefore, the IAIS needs to develop a process that ensures appropriate confidentiality, while allowing the IAIS, its members, and other important stakeholders to continue evaluating and improving the ICS over the next five years.

Third, Mr. Mnuchin noted that it was important that the IAIS strengthen its efforts to develop a final ICS that is implementable in the United States. Mr. Mnuchin noted that the ICS should recognize the diverse approaches to solvency regulation taken by various jurisdictions around the world, which includes the U.S. state-based regulatory system. Additionally, in a follow-up to the Mr. Mnuchin's remarks, NAIC President and Maine Insurance Superintendent Eric Cioppa echoed a similar sentiment regarding jurisdictional flexibility, highlighting the increasing concern from industry that the ICS is not implementable in its current form and alternatives may need to be recognized, as the current iteration of ICS may hamper insurers' ability to offer long-term products and make long-term investments.

Lastly, regarding the Holistic Framework, Mr. Mnuchin noted that the Treasury supports shifting the focus of systemic risk analysis away from individual insurance groups and instead towards looking at the activities insurers are undertaking. In recognition of this shift, the Financial Stability Board (FSB) did not publish a list of global systemically important insurers (G-SIIs) in 2017 or 2018. Mr. Mnuchin noted that the Treasury and the Financial Stability Oversight Council (FSOC) continue to work on this activities-based approach—rather than an entity-based approach—to be used in the evaluation of systemic risk in the financial sector. The FSOC has also, earlier this year, released proposed guidance[2] that describes the approach the FSOC intends to take in prioritizing its work to identify and address potential risks and emerging threats to U.S. financial stability.

CEO PANEL OFFERS PERSPECTIVE ON KEY INSURANCE INDUSTRY DEVELOPMENTS

The chief executives of AIG, MassMutual, Guardian Life and Hamilton Insurance Group lent some insight on topics of importance impacting their businesses, and the industry overall. Initial discussions were geared around areas of concern and opportunity. One central theme that arose centered on the use of technology. A common area of concern from the panel was the ability to attract top talent to the industry. Insurance has an aging workforce and isn't seen as overly appealing to millennials. This means insurers have to be more proactive and creative in its recruiting approach to attract the next generation of staff and leaders. An area of opportunity that can be used to fill this void is through the increased use of technology within the industry. As insurers incorporate technology more into their operations, leveraging millennials' digital know-how offers companies the ability to understand what those in their demographic want from a consumer experience. Additionally, on the product side, technology can also offer opportunities to provide access to products for more people by lowering cost, which can help to better cater to underserved parts of the population.

Staying with the theme of technology, additionally on the regulatory front, instantaneous access of information is now an expected aspect of the consumer experience. In order for insurers to effectively cater to the consumer, there needs to be a harmonization of the rules among states. As states look to increase regulation on data uses, this can add complexity for insurers and subsequently add costs when rules amongst the states don't complement one another. The cost to develop products and services is relatively high, but technology can be a solution, if the rules insurers operate under are receptive to new uses of data.

The flip side to this argument is that regulators are showing a level of distrust of companies' use of external data, predictive models and algorithms, as these could negatively impact availability and affordability of insurance products for certain

[1] The market valuation approach focuses on the comparability of the valuation of assets and liabilities across insurance groups in various jurisdictions. Adjustments will be needed to account for differing accounting requirements to ensure a level playing field when determining capital requirements.

[2] The FSOC's proposed interpretive guidance on nonbank financial company oversight: https://home.treasury.gov/system/files/261/Notice-of-Proposed-Interpretive-Guidance.pdf

consumers. This creates a sensitive dilemma for insurers. The insurance industry is defined by risk management, and risk management is ultimately deciding which risks insurers are and aren't willing to take on. The key is to not unfairly discriminate in the selection and rate setting process, but it's up to regulators to ensure fairness protections for consumers.

The conversation moved to the challenges of Brexit and the shift globally to more nationalistic interests. A big concern, in general, was what world will look in five to ten years. Will there be further fracturing within the EU? What will happen with trade? And how will these risks affect the insurance marketplace? Companies have already responded to Brexit-related prospects by shifting operations across the continent or creating new outposts to retain passporting rights. These uncertainties will require firms to become even more nimble and agile, as they try to minimize potential disruptions in their business models due to geopolitical outcomes around the globe.

To conclude, the conversation shifted to the ICS and the Holistic Framework. Members of the panel openly questioned the need for ICS. The sentiment being that industry already has an "equivalency" framework in place that regulatory regimes operate under, along with the difficulty of creating a common capital regime. Looking at Solvency II, many in the industry have expressed unhappiness with it and it appears to be a constant work in progress, even after implementation. It was also expressed that while capital serves a purpose, it doesn't solve all problems. The levels of capital a company has can indicate strength, but companies can fail for a host of reasons (e.g. AIG's struggles during the crisis were more related to liquidity). Also, the downside of ever increasing capital requirements is that it leads companies to stop innovating, and thus there needs to be a delicate balance between required capital levels and responsible risk taking.

DISCUSSION ON SYSTEMIC RISK HIGHLIGHTS THE INDUSTRY'S CONCERNS WITH GLOBAL STANDARD SETTING

The forum's final discussion focused on the evolution of how regulators and the IAIS look at systemic risk within the insurance industry. The global financial crisis highlighted the interconnectedness of the financial system and the risks presented when the system comes under duress. While traditional insurance is designed to provide stability during times of stress, certain activities of insurers could lead to increased systemic risk within the industry. As a result, the IAIS and the FSB has worked to design a process to assess systemic risk and policy measures to limit catastrophic failure in the sector. In 2013, the FSB identified an initial list of nine insurance groups it considered to be globally systemically important insurers (the G-SII list). But as coordinated supervisory oversight continued to develop, it became apparent that taking an "entities-based approach" to assessing systemic risk may not have been the most prudent way to assess risk in the system, and shift was made to take more of an "activities-based approach" to assess systemic risk. At the end of 2018, the IAIS released its Holistic Framework, which is intended to take a broader, more defined approach to addressing systemic risk.

Jonathan Dixon, Secretary General of the IAIS, provided a brief update on the development of the Holistic Framework, detailing that the IAIS aims to adopt the framework by November of this year. There are also further plans to request that the FSB to suspend the G-SII framework, with the intended goal of it being eliminated once the IAIS' Holistic Framework has been implemented. Mr. Dixon also detailed the key elements of the Holistic Framework, which include enhanced policy measures pertaining to liquidity risk, macroeconomic exposures and counterparty exposures; global monitoring, which will include cross-jurisdictional information exchange and confidential data collection from individual insurers; and the IAIS' response should systemic risk be identified, which could include restrictions on new underwriting and dividend distributions, increased capital requirements, and providing access to short-term lending facilities if insurers are confronted with pressing liquidity needs.

One concern detailed by the panel was the risk of overregulation. Regulation naturally incentivizes and disincentivizes certain behavior, but could macroprudential regulation unintentionally lead to increases systemic risk? Could regulation cause meaningful, industry affecting asset allocation shifts? Do the various pieces of regulation (capital and risk management, resolution and recovery planning, stress and liquidity testing, etc.), fit together to ensure risks are being minimized globally? These are the things the industry feels the IAIS must sort out to ensure practical oversight.

Another area of concern was how risks have evolved since the crisis, including increased risks related to FinTech, cyber-attacks and artificial intelligence. Emerging technologies can be a value-add as companies look for ways to increase automation and create efficiencies, but the reliance on things such as complex algorithms and cloud computing has created additional risks that needs to be taken into consideration.

Lastly, global consistency and how it will play into this new era of supervisory coordination was also an area of focus. The idea of global standard setting is not just new for affected firms, but also for the regulators responsible for supervising them. It's a new line of thinking: Being concerned about the solvency of the global system as a whole, as opposed to just the individual firms that operate in it. Regulators should desire to avoid duplication within the industry's global oversight efforts, to minimize the complexities of firms' having to deal with global and local regulatory compliance. Furthermore, global regulations have never been harmonious and past convergence efforts, whether in accounting standards or capital requirements, have always left a lot to be desired. So while global standards are the goal, there still needs to be a recognition that there is not a single, global market. Rather, it's a collection of regional and segmented markets that are not easily comparable to one another. The industry remains very wary of the direction of global standard setting, not wanting new standards to negatively affect product availability and the assets the industry holds, which play an essential role in the stability and growth of the world's collective economies.

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