ENTERPRISE RISK
MANAGEMENT SYMPOSIUM

Enhanced Supervision and Group Capital Standards

Perspectives of a non-bank SIFI and G-SII

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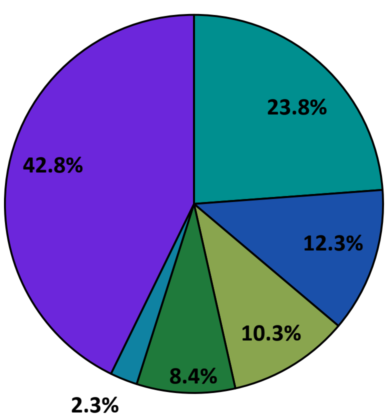
Prudential Overview

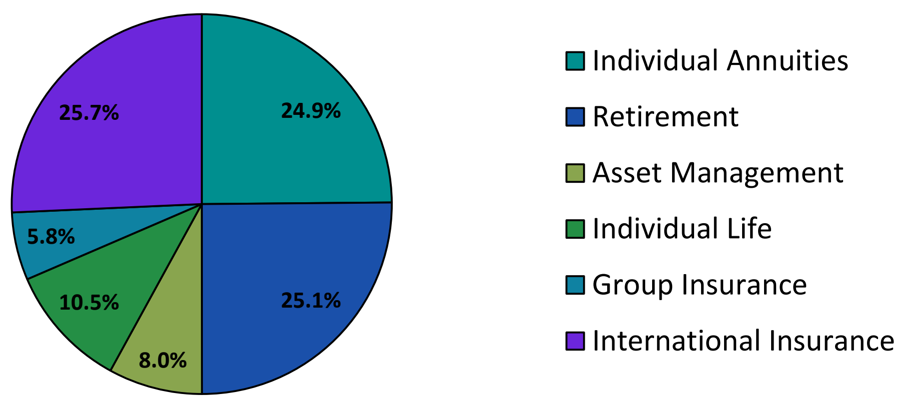
- Prudential Financial, Inc.
  - Headquartered in Newark, NJ
  - 140-year history
  - Operations in U.S., Asia, Europe and Latin America
  - Over 49,000 employees, more than half outside the U.S.
  - $1.184 trillion in assets under management as of December 31, 2015
- Offering a variety of products and services, including life insurance, annuities, retirement-related services, mutual funds and investment management
- Organizational structure comprised primarily of domestic regulated insurance entities, international regulated insurance entities and non-insurance entities

Amounts as of December 31, 2015

Adjusted Operating Income



Total Assets



Enhanced Supervision in the U.S. Context

Dodd-Frank Act

Financial Stability Oversight Council (FSOC)

Systemically Important Financial Institution (SIFI) Designation
6 designation criteria
3-stage process

Federal Reserve Board authority to supervise SIFIs

Federal Group-wide Supervisor
Continuous Monitoring
Enhanced Continuous Monitoring Examination

Rules for SIFIs

Capital and Stress Testing, Liquidity, Recovery and Resolution Plans…

Additionally, state group-wide insurance supervisory authority is emerging through the NAIC Holding Company Model Act.

ENTERPRISE RISK MANAGEMENT SYMPOSIUM

Enhanced Supervision in the Global Context

The Group of Twenty (G20)

Financial Stability Board (FSB)

International Association of Insurance Supervisors (IAIS)

Jurisdictional Authorities / IAIS Members include:

NAIC and states
Federal Reserve Board (FRB);
Federal Insurance Office (FIO)

European Insurance and Occupational Pensions Authority (EIOPA)

…

(140 countries in total)

- **G20** – political authority
- **FSB** – financial regulatory policy makers
- **IAIS** – insurance sector translation
  - **Global Systemically Important Insurer (G-SII) designation and policy measures**
    - Annual G-SII designation
    - Capital / Higher Loss Absorbency
    - Recovery and Resolution Plans
  - **Standards for Internationally Active Insurance Groups (IAIGs)**
    - ComFrame
    - Insurance Capital Standard
    - Insurance Core Principles (ICPs)
  - Implementation of standards through the **Group-wide Supervisor**

ENTERPRISE RISK MANAGEMENT SYMPOSIUM

Impacted Insurers

A small number of insurers are directly impacted by systemic designations and policies, but a significant number of insurers will be impacted by group-wide supervision.

Dodd-Frank Act

Insurance SIFIs
Prudential
AIG
MetLife

G-SIIs
Prudential
AIG
MetLife
Prudential Plc. (U.K.)
Aviva
Allianz
AXA
AEGON
Ping An

G-SII Policy Measures

FRB rules (non-systemic) → Savings & Loan Holding Companies

NAIC rules → U.S.-based insurers

Internationally active insurance groups (IAIGs) ← **ComFrame standards**

← Enhanced Supervision Impacts →

- Risk Management
- Governance
- Documentation
- Model Validation
- Counterparty Risk Management
- Liquidity
- Capital and Stress Testing
- Recovery & Resolution Planning
- ORSA

Federal Reserve Board Supervision

Objectives	• Safety and soundness of the supervised institution • Financial stability • Compliance with relevant laws and regulations
Supervision	• Customized to a firm's risk profile and organizational structure • Examine key aspects of firm's businesses and risk management • Assess the adequacy of systems and processes for identifying, measuring, monitoring and controlling the risks the firm is taking
Methods	• Continuous monitoring • Enhanced continuous monitoring • Examination • *These can be applied on a single firm basis or horizontally across firms*
Key Areas of Focus	• Activities identified as those likely to pose the highest risk to the firm • Risk management, capital planning and liquidity, stress testing • Enterprise-wide and strategic activities

Group Supervision – Supervisory Colleges

- Supervisors throughout the globe have recognized the importance of increased communication and cooperation through supervisory colleges.
- Supervisory colleges serve as a forum to facilitate communication and improve supervision at both the group and entity level.
- Prudential's supervisory college is made up of its major jurisdictional and group supervisors:

- **New Jersey Dept. of Banking and Insurance**
- **Arizona Department of Insurance**
- **Connecticut Insurance Department**
- **Federal Reserve Bank (Boston)**
- **Japan Financial Services Agency**

ENTERPRISE RISK MANAGEMENT SYMPOSIUM

Group-Wide Capital/Solvency Standards

Defining the group-wide capital requirements for insurers is a key focus for regulators and industry.

United States

Non-bank SIFIs

Federal Reserve Board

- Collins Amendment
- Capital rules for FRB-regulated insurers

Global

G-SIIs & IAIGs

IAIS

- Basic Capital Requirement (BCR)
- Higher Loss Absorbency (HLA)
- Insurance Capital Standard (ICS)

- Standards are being developed through consultation and quantitative exercises
- Key technical considerations include:
  - Valuation
  - Definition of available capital
  - Design and calibration of risk-based required capital (e.g., factor-based, modeled)
  - Ability to stress test the capital requirement

Federal Reserve Capital/Solvency Standards

- The U.S. insurance industry, at the request of the FRB, is collaborating to develop a proposal for an insurance appropriate solvency framework.
- Industry efforts are being coordinated through Life and P&C insurance trade associations.

Proposed Approach: Aggregation & Calibration (A&C) of Statutory Capital

- Leverages the accounting and established constructs of existing solvency regimes to provide a point-in-time measure of capital adequacy at the group level
- Group Solvency Ratio based on aggregation and scaling of capital for each entity (e.g., US RBC, Japan SMR, Basel III)
- Adjustments are made to eliminate the impact of intragroup transactions on capital
- Includes a stress testing regime, in which A&C will be subject to the FRB macroeconomic scenarios plus insurance stress

Global Capital Standards

- Global insurance players and supervisors are involved in the IAIS' development of capital standards for G-SIIs and IAIGs.

	Basic Capital Requirement (BCR)	Higher Loss Absorbency (HLA)	Insurance Capital Standard (ICS)
Target Firms	G-SIIs	G-SIIs	IAIGs
Purpose	Globally comparable baseline and foundation for HLA	Additional capital requirements (buffer) for systemic activities/relevance	Global Capital Framework (part of ComFrame)
Design	Factor Based (15 factors)	Bucket Approach increase to BCR factors	Distinct stresses with correlations
Target Date	2019	2019	TBD (2020 or later)
Status	Approved by FSB and G20 in 2014	Approved by FSB and G20 in 2015	Field Testing post initial consultation

Views on Appropriate Group-wide Capital Standards

ALIGN WITH THE FUNDAMENTAL ECONOMICS OF INSURANCE

- **Start with a meaningful valuation basis**
  - ❑ Symmetric valuation of assets and liabilities
  - ❑ Appropriate yield curve used to value insurance liabilities
- **Apply meaningful definitions of available capital and required capital**
  - ❑ Available capital is defined as all tangible loss absorbing resources not needed to support best estimate liabilities
  - ❑ Required capital is based on risks and how risks manifest themselves
    - ➢ Stresses should result in a plausible depiction of risk at a given level of severity
    - ➢ Risk diversification must be reflected

AVOID UNINTENDED CONSEQUENCES

- **The capital standards must not undermine the strength and stability of the insurance business model through:**
  - ❑ Artificial mismatches between assets and liabilities
  - ❑ Spurious volatility and pro-cyclicality in measures of insurer solvency
  - ❑ Artificially understating capital adequacy through improper design and calibration or excess conservatism
- **Unintended consequences include:**
  - ❑ Adverse impact to insurance product availability innovation
  - ❑ Adverse impact to insurers' role in providing stable, long term capital investment
  - ❑ Un-level playing field