Session 6: Implications for Risk Managers of the Future Trajectory of Regulation and Accounting Frameworks for US Insurers

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Session 6: Implications for Risk Managers of the Future Trajectory of Regulation and Accounting Frameworks for U.S. Insurers

Thursday, April 19, 2018 – 11:00am – 12:15pm

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Opening remarks

David Sandberg, FSA, CERA, MAAA
David Sandberg LLC

David Paul, FCAS, MAAA, FIA, FSAI
Executive Director, EY Insurance and Actuarial Advisory Services

ERM Enterprise Risk Management Symposium

Agenda

- Opening remarks
- Themes:
  - Changed climate for ERM – 2018 and beyond
  - Accounting frameworks
  - Risk quantification
  - US and international

Our session's objective:

- *Understanding recent developments*
- *An interactive discussion on the implications for risk managers*

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Changed climate for ERM - 2018 and beyond

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Third Treasury Evaluation Report

Important as the clearest confirmation, so far, of new administration's agenda

- Approach to SIFI's
- Changing the brief of FIO
- Group capital standards
- Other:
    - DOL Fiduciary Rule (delay)
    - Supportive of liquidity risk management programs for insurers
    - Suggests re-evaluating state insurance capital requirements "may be better calibrated to encourage insurer infrastructure investment"

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Third Treasury Evaluation Report

Report's position on SIFI's in the case of insurance:

- "Treasury's position is that entity-based evaluations of systemic risk are generally not the best approach for mitigating risks arising in the asset management and insurance industries"
- "Treasury broadly supports shifting to an activities-based framework, which would identify certain business activities as having higher systemic risk characteristics"
- "Rather than focus on entity-based systemic risk evaluations, insurance regulators should focus on potential risks arising from insurance products and activities, and on implementing regulations that strengthen the insurance industry as a whole"

Third Treasury Evaluation Report

Report's position on FIO:

- Treasury is committed to "realigning" the operations of the FIO, an office created by the Dodd-Frank Act, in a way that will promote the state-based insurance regulatory system "and make FIO's work more effective."
- The report says FIO should encourage "uniform product approval processes and standards at the state level, which will expedite the speed of bringing new products to market."
- Treasury is also committed to increasing transparency and stakeholder engagement at the FIO, "and will implement mechanisms to achieve these objectives. For example, Treasury is committed to making its international negotiating posture and actions more accessible to various stakeholders through both public and private forums."

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Third Treasury Evaluation Report

The report describes actions to harmonize the two current group capital U.S. initiatives as follows:

- The FIO to consult first and then coordinate a single approach between Federal Reserve, state insurance regulators and the NAIC
- The FIO then to advocate for the U.S. approach to group capital in international forums

Developing Risk Management in 2018 and beyond

Important questions that risk managers should be asking themselves and considering include:

- If regulatory involvement in ERM is on a 'light touch' basis, is that good or bad?
- How can ERM installations prosper and will their impact on businesses grow? If they were installed only to comply (e.g. with NAIC ORSA), does that make them more at risk?
- If we choose to prioritize some aspects of ERM over others, where to focus:

Risk identification and monitoring (process)	Developing 'own solvency' concept	Emerging Risk management
Risk quantification	Capital management	Rating Agency ratings
Governance	Solvency projections	Reinsurance & alternative capital

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Accounting Frameworks

Identifying key stakeholders: Accounting boards

Along with Statutory financial reporting guidance developed by the states and the NAIC, there are two major accounting boards that develop guidance impacting insurers:

- International Accounting Standards Board (IASB)
  - International Financial Reporting Standards (IFRS)
- Financial Accounting Standards Board (FASB)
  - US Generally Accepted Accounting Principals (GAAP)

Understanding recent developments

A number of very important regulatory and accounting developments are underway, a selection of which we have noted below:

Financial reporting changes	Group capital standards	“Other” developments
• IFRS 17 • FASB Targeted Improvements • Principle-Based Reserves (PBR)	• Insurance Capital Standard (ICS) v2.0 • NAIC Group Capital Calculation • Federal Reserve capital	• EU/US Covered Agreement • Federal guidance (e.g., FSOC, US Treasury, FIO) • Recent NAIC activity

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Risk Quantification

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Risk Quantification – historical perspective

- Risk-based Capital rules in the US since Early 80’s
- Propagation of ‘economic capital’ ideas and approach – late 90’s, early 00’s
  - Market consistent valuation consistent between assets and liabilities; Risk Margin; VaR-type tail metric for capital
  - Largest multi-nationals since early 2000’s (and largest US companies participated in <European> CRO Forum)
  - Prolonged development 2004 – 2016 becoming Pillar 1 of Solvency II
  - EC underpins IAIS development of ICS (International Capital Standards)
- Stress and scenario testing – increasingly applied post 2007-2009 crisis
  - Flexible in its application – can be applied to GAAP or STAT or EC basis
- Modernization of insurance balance sheets upcoming from IASB and FASB

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“Own Solvency” measurement in ORSA

- State Department of Insurance implementation of ORSA in US based on NAIC guidance and model law
- Effective since 2015 – 2016 – companies have now stabilized into regular annual reports
- Conducive to Board and Executive setting a quantitative risk appetite statement and consequent risk quantification used for the “own solvency” concept
- Significance of US ORSA:
  - *Arguably is the single regulatory driver given decline in influence of Fed or ICS*
  - *NAIC Guidance requires own solvency to be computed <u>and</u> projected but is agnostic on methodology*

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Risk Quantification – future trajectory for risk managers

Important questions that risk managers should be asking themselves and considering include:

- Is NAIC ORSA an enabler or a regulatory burden? How can it be used to your companies' advantage?
- Given that NAIC ORSA 'own solvency' is agnostic on methodology – how does risk management develop the approach?
- Will State DOI's start to interact more with companies on the content of their ORSA?
- Will State DOI's trend towards placing greater significance on an ORSA internal metric? (and consequently less on RBC, for example?)
- *Danger: will repetition and familiarity cause ORSA to wither on the vine?*

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US and International

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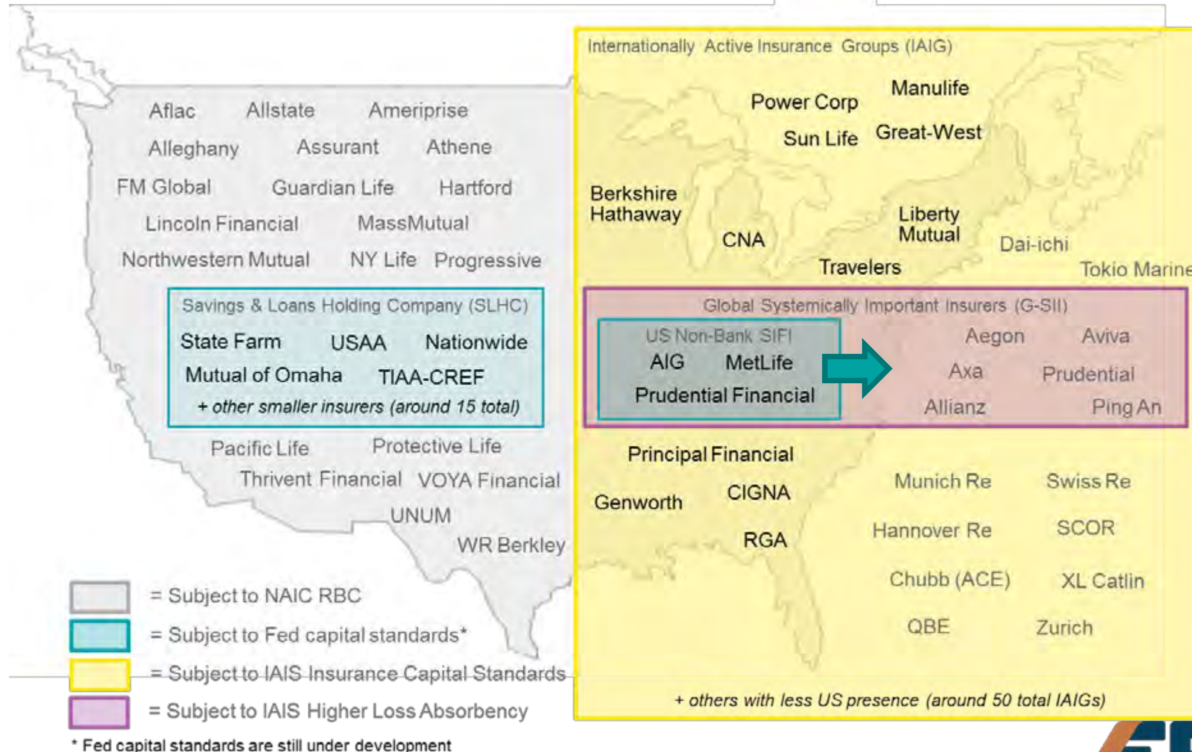
US and International

- US EU Covered Agreement
  - US & Solvency 2 considered equivalent
  - Only lead regulators oversees the group, rest participate via the supervisory college
  - Only one group capital calculation
- Kuala Lumpur agreement
  - Commitment from the US, Europe and others on a path to a common language for supervisory discussions of group solvency
  - Five year confidential monitoring phase based on a common ICS (2.0) requirement
  - Optional additional reporting based on the discretion of the lead group supervisor. This may interest US, Canada and Japan supervisors.

regulatory map



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US and International

1. How many here have a State Lead Supervisor?
2. How many have the Fed as their group Supervisor?
3. How many have OSFI as the lead Supervisor
4. Other countries?
5. How has your supervisory college worked to create a common understanding across jurisdictions?

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Key Group Capital Open Questions

- Requirement or calculation?
- Based on a comprehensive set of financial statements?
- What legal actions could/should flow from it?

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Implications for risk managers

Important questions that risk managers should be asking themselves and considering include:

- What risks are there in emerging regulatory and accounting developments beyond implementation? When do multiple reporting lenses become too many to accurately capture important aspects of insurance?
- What key implementation decisions will need to be made across developing regulatory and accounting standards and what trade-offs exist as a consequence of those decisions?

Q & A

Thank you for joining our session

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