The New Insurance Supervisory Landscape: Implications for Insurance & Pensions

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The New Insurance Supervisory Landscape: Implications for Insurance & Pensions

- Current Supervisory Landscape
  - Overview & Supervisory Issues
- Recent Developments
  - United States, Europe, Global
- Effects on Market Structure, Conduct, Performance
- Social Welfare Dimensions & Tradeoffs
- Examples of Possible Market-Wide Effects
  - Financial stability & capital allocation
  - Conduct policies & market coverage
  - Prudential vs. conduct policies
  - Product risks & provision
  - Resolution methodology & capital efficiency
  - Regulatory policies & investment pro-cyclicality
  - Application of bank-oriented prudential standards within insurance sector
  - Systemic risk methodology, international capital standards, and firm structure
  - Risk weightings applied to sovereign debt and systemic risk
- Future Challenges
- Conclusion

Tapestry Networks operates at the intersection of government, business, and society

- Our mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency.
- As an independent chair of these interactions, we have helped:
  - Finance: policy and economic leaders design effective systems to support financial stability
  - Healthcare: European healthcare leaders develop new approaches for providing critical medicines
  - Transparency: directors from the boards of publicly traded companies in North America and Europe create agenda for strengthening financial reporting and disclosure

Insurance Leadership Network: Global Insurance Directors + Policy Leaders

KEY

Participating insurers
Participating organizations

CANADA

- OSFI
- Sun Life Financial

UNITED KINGDOM

- Aon
- Aviva
- Direct Line Group
- FCA
- Old Mutual
- PRA
- RSA Insurance Group
- Scottish Widows
- Standard Life

WESTERN EUROPE

- AEGON
- ACPR, France
- AFM, Netherlands
- Assicurazioni Generali
- AXA Group
- CNP Assurances
- DNB, Netherlands
- EIOPA
- ING Group
- SCOR
- Swiss Re
- XL Group
- Zurich Insurance Group

GLOBAL

- IAIS

ASIA

- China Life

UNITED STATES

- AIG
- Federal Reserve System
- FSOC
- Liberty Mutual
- Lincoln Financial Group
- MetLife
- Moody's Investors Service
- NAIC
- State insurance depts
- State Farm Mutual
- Travelers

AFRICA

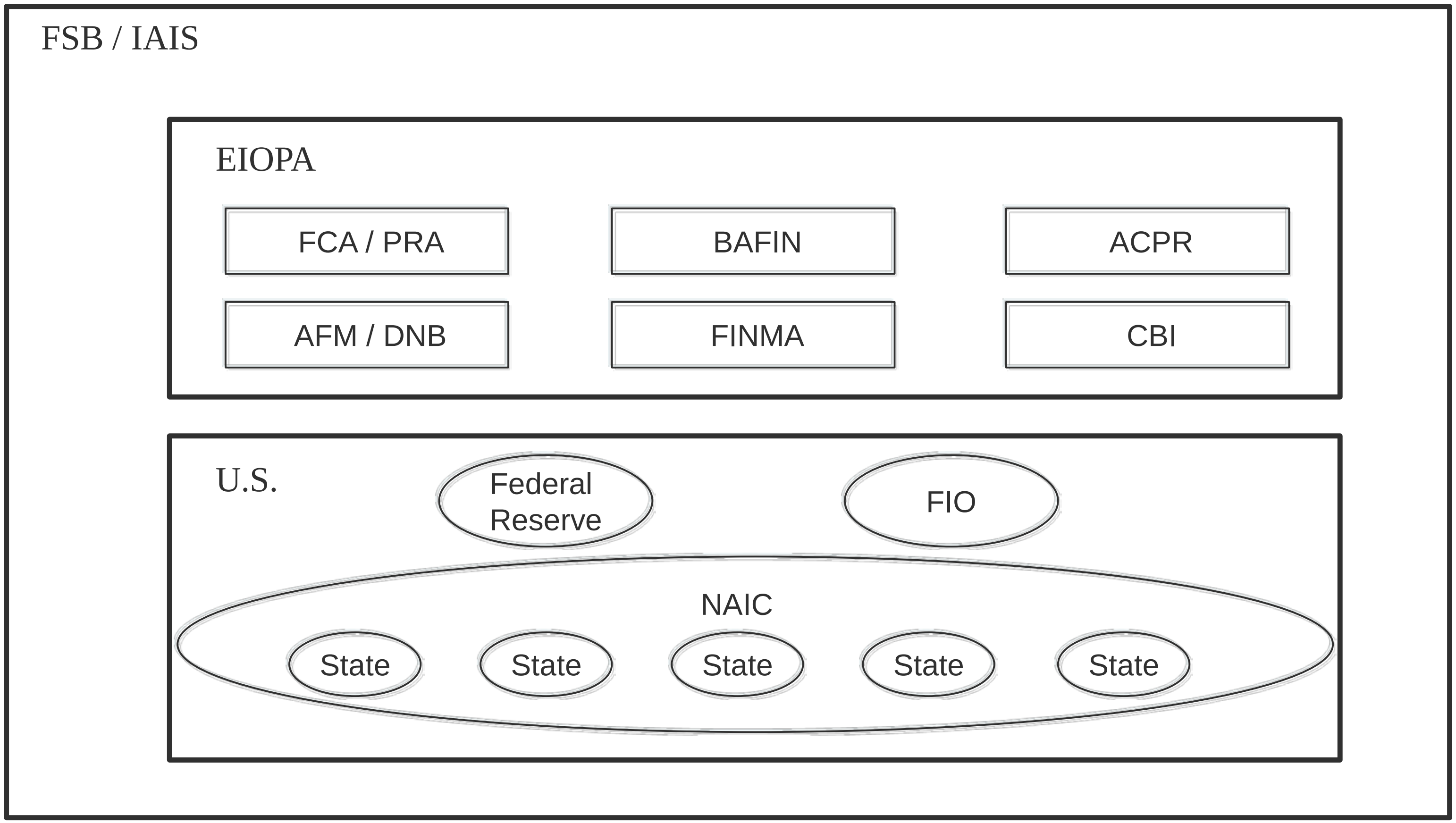
- Sanlam

AUSTRALIA

- QBE
- APRA

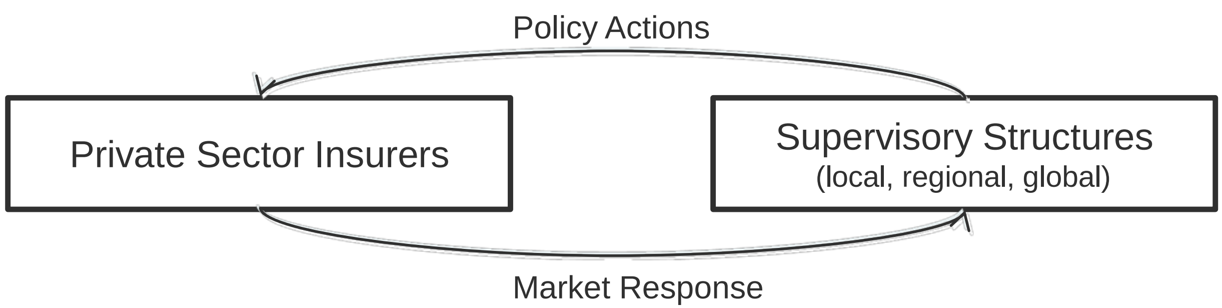
Current Insurance Supervisory / Regulatory Structures

Figure 1: Insurance Regulatory/Supervisory Structures



Industry-Policy Feedback Loops Influence Social Welfare Outcomes

Figure 2: Industry-Policy Feedback Loops Determine Social Welfare Outcomes

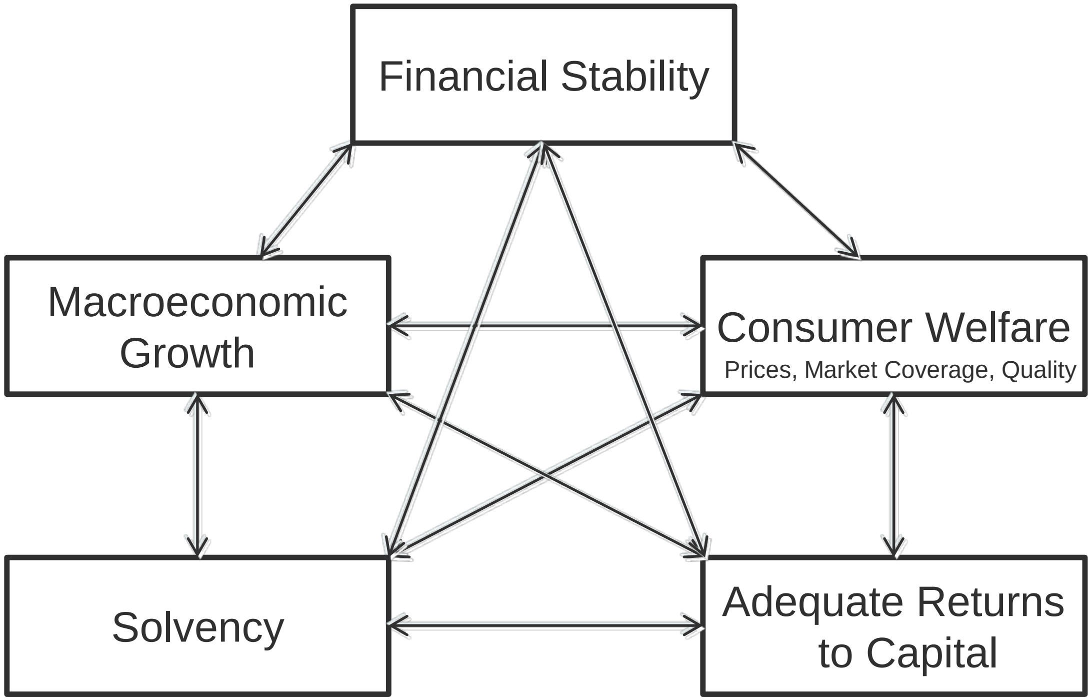


- Product decisions: pricing, design, pricing.
- Customer decisions: target customer, risk selection, underwriting standards.
- Geographic decisions: geographic presence, corporate domicile, group vs. subsidiary structures.
- Investment decisions: asset allocation, time horizons, asset-liability matching, risk/return profiles.

- Solvency: capital & liquidity requirements, capital standards, risk-weighting, investment guidelines..
- Financial stability: systemic designations, capital & liquidity requirements, NTNIA treatment, RRP requirements.
- Consumer protection: conduct policies, product & pricing approvals.
- Governance & coordination: board requirements, supervisory colleges, risk management policies.

Social Welfare Dimensions & Linkages

Figure 3: Social Welfare Considerations



The Accomplishment of Policy Objectives …

Financial Stability

Consumer Protection

Solvency / Funding

Good Governance

Supervisory Coordination

… is Constrained by the Limitations of Supervisory Action

Geographic Scope

- Second-order effects of policy actions lie outside supervisors' geographic scope.
- Ability of policy-makers to accomplish policy objectives lie outside geographic authority.

Policy Mandates

- Effects of pursuing one policy objective result in second-order effects in the achievement of other policy objectives (prudential, conduct, solvency, capital, product approvals, pricing).

Uncertain Side Effects

- Some effects of pursuing policy objectives are either unknown, uncertain, unquantified, or unacknowledged.

Proximate vs. General Equilibrium Effects

- Supervisory authorities primarily focus on proximate and primary policy objectives.
- Social welfare effects of policy actions are multi-dimensional, lie partially outside policy mandates, and result from ultimate general equilibrium effects.

There are Many Areas of Supervision with Multiple Social Welfare Tradeoffs (I)

- **Financial stability & capital allocation**: ensuring financial stability at very high levels of certainty within multiple supervisory locations can result in very highly capitalized legal entities using immobile, non-fungible capital (higher financial stability, lower returns to capital and economic growth).

- **Conduct policies and market coverage**: pursuing consumer protection and conduct objectives aggressively can ensure high levels of protection, but at the cost of reduced market coverage, lower levels of product market competition, and reduced innovation (higher consumer protection, lower market coverage and higher prices).

- **Product risks and provision**: ensuring solvency for some product structures at very high levels of certainty can result in market exit, loss of product provision, and reduced price competition (higher solvency, lower market coverage and higher prices).

- **Resolution methodology & capital efficiency**: the limited ability of multiple local supervisors to coordinate and develop binding commitments in times of stress results in higher levels of locally held capital within multiple geographies (greater financial stability and solvency, lower returns to capital and economic growth).

There are Many Areas of Supervision with Multiple Social Welfare Tradeoffs (II)

- **Regulatory policies and investment pro-cyclicality**: creating a closer connection between current market investment valuations and capital level recognition can amplify capital market fluctuations (both prices & flows) and cause higher pro-cyclical variance in regulatory capital levels (more timely solvency recognition, lower financial stability, possibly lower economic growth).

- **Systemic risk methodology, international capital standards, and firm structure**: ensuring high levels of financial stability and consistent supervision globally can motivate international firms to dis-integrate into smaller, local entities, resulting in lower economies of scale and partitioned capital (higher financial stability, more standardized supervision, lower returns to capital and economic growth).

- **Risk weighting applied to sovereign debt & systemic risk**: assigning zero risk weightings to sovereign debt avoids difficult international political issues, but motivates firms to invest heavily in riskier sovereign debt and strengthens connections between sovereigns and financial institutions (higher likelihood of standards adoption, higher systemic risk).

Future Outlook / Opportunities for Improvement

Supervisory Coordination

- International Association of Insurance Supervisors
- ComFrame
- Team USA: Fed, NAIC, FSOC
- Observer roles, cross-advisory roles

Policy Clarity

- Statements of specific objectives and rationale
- Identification of touch-points between supervisory mandates
- Acknowledgement of policy tradeoffs within mandates

Improved Understanding of Outcomes

- Acknowledgment of potential unintended consequences
- Dialogues with industry to understand and adjust to system dynamics
- Select quantitative / qualitative studies to identify important second-order effects

Greater Allowance for Multiple Dimensions of Social Welfare

- Acknowledgment of effects on multiple dimensions of social welfare and consequences outside bounds of supervisory mandate
- Openness to modifying supervisory tools / actions to accomplish more beneficial outcomes across multiple social welfare dimensions

Implications for Insurance / Pensions / Retirement Security

- Annuity provision, pricing, features, guarantees, innovation, availability
- Capital market pricing volatility and stability
- Market coverage of products, customer segments, geographies
- Financial advice provision and coverage
- Transfer of longevity risk
- Pension settlement

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New ways to govern and lead

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