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Insurance regulation is at a crossroads. Faced with an increasingly globalized and dynamic industry, the painful lessons of the financial crisis, dramatic and disruptive advancements in the use of technology, creeping protectionism and nationalism in many markets, competing regulatory agendas and good faith differences in regulatory approaches, insurance regulators are at an important juncture and have the chance to chart their course for the near to mid-term. The choices they make could lead to greater regulatory effectiveness and efficiencies, or result in further Balkanization of regulation and an ever heavier, costlier and at times conflicting set of regulatory rules for insurers. The potential impacts on the insurance industry and those consumers who rely on it are significant.

This paper reflects on the evolution of insurance regulation over the past decade (2007-2017) and offers thoughts on some of the critical choices regulators and the industry need to make going forward. In doing so, it focuses on developments primarily from the onset of the financial crisis and the regulatory response to the crisis. It looks at the positive developments that have taken place and some of the important lessons learned. It also examines what some consider to be misdirected activities and inevitable overreactions to the crisis. This paper considers certain critical new developments that may present regulators with the opportunity to reexamine and perhaps redirect their limited, finite regulatory resources. It is not intended to be a comprehensive report of all key developments during this period, but it aims to highlight some key initiatives and the critical regulatory policies that we believe deserve attention.

This paper reflects our personal views. It does not reflect the particular views of any of our clients, although our views have certainly been developed as a result of many decades of advising insurers and other financial services industry players on regulatory matters. We hope this analysis will contribute to the ongoing and much needed discussion over the evolution of insurance regulatory policy globally. Getting that policy right matters.

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THE CALM BEFORE THE STORM

On January 1, 2007, insurance regulation was centered largely on legal entity regulation with almost complete deference to the domiciliary regulator of the insurer. A focus on group supervision was emerging, but nascent. Insurance holding company regulation had a long tradition in the US, while Solvency II, which was being developed (work began in 2001) included a more robust and comprehensive approach to group supervision, in addition to many other provisions. Also, enterprise risk management requirements were beginning to take root.

At the same time, the International Association of Insurance Supervisors (IAIS) was working on efforts to improve cooperation and communication among global regulators. They were also beginning to talk about common structures and common standards for assessing capital adequacy and solvency. Corporate governance and risk management practices were also emerging on their agenda, along with finite reinsurance concerns, insurance fraud and related matters. In February 2007, the IAIS adopted its Multilateral Memorandum of Understanding, which it hailed as a breakthrough to promote close cooperation and information exchange among insurance supervisors.

Overall, however, it was an era of relative regulatory calm, albeit with increasing activity among global regulators.
THE STORM

By mid-2007, the landscape had changed radically, as global financial markets began to shudder. The early trauma was to the banking sector. It was not until mid-2008 that the crisis hit the insurance industry. Memories are short, but in September/October 2008 the financial system was close to the precipice in its worst crisis since the Great Depression. In just a six-week period in September/October 2008: (a) the US took control of Fannie Mae and Freddie Mac; (b) Lehman Brothers filed for bankruptcy; (c) Merrill Lynch announced its sale to Bank of America; (d) the Federal Reserve extended a $85 billion credit facility to AIG; (e) the Reserve Primary Money Fund NAV fell to below $1; (f) Goldman Sachs and Morgan Stanley converted to bank holding companies largely to have access to the Federal Reserve Discount Window; (g) WaMu Bank failed and was sold to JP Morgan; and (h) Wachovia Bank was sold to Wells Fargo.

Although it is true that the financial crisis was primarily a banking and capital markets crisis, and not an insurance crisis, the near collapse of AIG made it inevitable that there would be enhanced prudential regulation for insurers, particularly non-bank systemically important financial institutions.

At the 2008 IAIS Annual meeting in Budapest, the IAIS became the de facto coordinating center for the global response to the crisis at AIG. US, UK and other global regulators met extensively, discussing developments, regulatory reactions and concerns. Although driven by external events, global regulators can and should be proud of the level of cooperation and coordination displayed during the crisis.

These events ushered in a decade of unprecedented international and, in many countries, domestic insurance regulatory activity. Some of this was merely an acceleration of developments already under way (eg, group supervision and peer review among regulators), but others, such as systemic risk regulation and a special focus on internationally active insurance groups, emerged directly out of the crisis.

The scale and severity of the crisis in the broader economic system created a sense of urgency and, indeed, fear, as regulators scrambled to keep up with fast moving events. Regulatory responses to the crisis included many positive steps, but as always, regulatory over reaction was a constant danger. In certain jurisdictions, regulators began to evidence something close to a zero risk tolerance. Moreover, because the root cause of the crisis was in the banking sector, banking regulatory issues drove the response and dominated much of the regulatory thinking − even vis-à-vis the insurance sector. Certainly the Federal Reserve Board, the Bank of England and the Financial Stability Board (FSB) − founded, in 2009, as a result of the financial crisis by the G20 leaders − all viewed the world through a banking lens.

As an immediate result of the financial crisis, the IAIS was directed by the FSB to develop a system for identifying globally systemically important insurers (G-SIIs) and to establish new capital standards for these insurers (known as the Basic Capital Requirement, BCR, and Higher Loss Absorbency, HLA). Despite much debate − and some persuasive analysis that indicated that no insurer was of a scale and with a level of connectedness to the financial system to pose a systemic risk − the IAIS ultimately identified nine insurers as G-SIIs.

In addition, the IAIS began development of a Common Framework for Supervision of Internationally Active Insurance Groups (ComFrame) which was to include a set of international supervisory requirements focusing on the effective group-wide supervision of a newly designated class of insurers called “internationally active insurance groups” (IAIGs). It was to be comprised of a range of quantitative and qualitative requirements specific to IAIGs and to provide requirements and protocols for supervisors of IAIGs. ComFrame was to build on the IAIS Insurance Core Principles (ICPs) which lay out fundamental principles of effective insurance supervision. The ICPs essentially serve as a basic benchmark for insurance supervision in all jurisdictions. The ICPs were first issued in 1997 but were significantly revised in 2011 in response to the global financial crisis (and are currently being revised further).
In the US, there was also a flurry of activity resulting from the financial crisis. In June 2008, the NAIC launched its Solvency Modernization Initiative (SMI). The SMI was focused on reassessing the US solvency framework, revisions to US reinsurance regulation, enhancement of group supervision and corporate governance rules, among other matters. More recently, the NAIC followed up with its Macro Prudential Initiative (MPI) which is a logical continuation of its SMI project. The MPI was intended to promote greater insight into how insurers react to financial stress and how that reaction can impact policyholders, other insurers and financial market participants and the public. In 2011, the NAIC adopted the Own Risk and Solvency Assessment (ORSA) Manual, which provides guidance to insurers on how to conduct an ORSA. This was followed by the ORSA Model Act in 2012. Most importantly, the Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was passed in 2010. That statute established the Federal Reserve Board as the regulator of systemically important insurers (as well as insurers that were subject to FRB regulation as savings and loan holding companies), the Financial Stability Oversight Council (FSOC) and the Federal Insurance Office (FIO).

Of course, the developments from 2008 on were not all coordinated or harmonized. When one considers the number of regulators (or other institutional actors) and the different demands − the Federal Reserve Board, the US Treasury, the state insurance regulators, the NAIC, the FDIC, the EU Commission, European Insurance and Occupational Pensions Authority (EIOPA), major European regulators like the UK Prudential Regulatory Authority (PRA) and the Japan FSA, the Financial Stability Board (FSB) the IAIS, etc. − finding common ground and a common agenda was nearly impossible. For internationally active insurers, including the G-SIIs, it felt like they were taking fire from all sides.

As the decade of post-crisis regulatory transformation came to a close, two additional notable events took place. The first was the launch of Solvency II. On January 1, 2016, after a 14-year gestation period and billions of euros/pounds of development costs, Solvency II became effective. In addition, to its new capital, risk management and group supervision provisions, the EU launched its process of equivalence assessments of other jurisdictions. Some countries, such as Switzerland, Bermuda and Japan, applied for review and obtained various levels of equivalence. The United States said “no, thank you,” making it clear that it was not going to seek equivalence. Some other countries followed suit.

Secondly, on January 13, 2017, the US and the EU announced the completion of negotiations on a Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance. This historic bilateral agreement, often referred to as the EU-US Covered Agreement, provides for a remarkable level of regulatory cooperation and, most importantly, regulatory recognition and deference. In this agreement both the EU and the US essentially agreed that each would recognize and defer to the other in important areas of group supervision (including group capital requirements) and reinsurance regulation and eliminate certain significant host country regulation in these areas. Although there has been some well-pointed criticisms of the process surrounding the negotiations and of some of its provisions, the EU-US Covered Agreement is a precedent-setting agreement with significant implications for the future of insurance regulation.
A TURBO-CHARGED DECADE OF CHANGE

The last ten years has reshaped global insurance regulation profoundly. Some of the changes have been positive and clearly required. As to be expected, some changes are viewed as excessive, uncalled for or misdirected. It is also true that the torrid pace of change over the last 10 years has created a serious case of regulatory fatigue among insurers (and we suspect some regulators). The changes have certainly consumed an extraordinary amount of management and regulatory resources.

Accordingly, it seems timely to consider what regulatory standards, protocols and practices have worked, what have been balanced and proportional and what efforts have been ineffective or excessive. Most importantly, the question “Where do we go from here?” needs to be addressed. As we look back over developments from 2007-2017, we also need to take stock of some of the regulatory successes and excesses.

“The effects of the financial crisis on insurers and policyholders were generally limited, with a few exceptions. While some insurers experienced capital and liquidity pressures in 2008, their capital levels had recovered by the end of 2009. Net income also dropped but recovered somewhat in 2009. Effects on insurers’ investments, underwriting performance, and premium revenues were also limited.”

But as noted, improvements were needed — and many have been implemented. These include:

Group-wide supervision.

Group-wide supervision was re-emphasized and has been strengthened post-crisis. Today, there is a much more holistic approach to group supervision and it is much less likely that critical non-insurance affiliates will escape the umbrella of regulatory oversight or rigorous supervision, which was one of the serious problems that impacted AIG through its financial products subsidiary. The IAIS redoubled its efforts on group supervision, The Fed applied its form of consolidated group supervision to insurers over which it has charge, the NAIC amended its Insurance Holding Company System Model Act and Model Regulation by developing its “windows and walls” approach to provide greater access to non-insurance entities within the holding company structure and also launched a project to create a group capital calculation for US insurers. Supervisory colleges developed dramatically, providing valuable opportunities for global regulators of an insurance group to meet, share information, discuss issues with senior management and take a holistic assessment of the group’s operations.
Corporate governance.

Corporate governance policies and procedures have been substantially improved. This includes requirements that all policies and procedures are in writing, the roles and responsibilities of officers are clarified and delineated, persons of authority have accountability, any reported deviations are escalated to appropriate levels and board engagement and oversight of senior management have been enhanced.

Stress testing.

Stress testing has become a widely accepted and important regulatory and management tool. Led mainly by the work of actuaries and chief risk officers, insurers have become increasingly aware of and more sophisticated in assessing the impact on their companies of various scenarios of market and environmental conditions. This risk management tool has also acquired significant regulatory support. Stress testing is now part of many regulatory ORSA and ERM requirements.

In 2016, EIOPA launched a stress test across the EU insurance sector which has now become an annual exercise. For insurers, stress testing encompasses stress factors that face financial institutions at large, but must also recognize the unique impact on insurers from various stress scenarios, particularly where they include a potential increase in frequency and severity of claims. In addition, stress testing includes liquidity risk management. Liquidity testing is distinctly different from capital adequacy requirements and, we suggest, of greater relevance to insurers than additional capital standards. There is no doubt that its embrace by regulators and management has had a positive impact on the financial resilience of the insurance sector.

A stress test, however, is only as good as the scenarios and assumptions on which it is constructed. Hypothetical and implausible scenarios undermine the usefulness of this tool. Accordingly, balance, reasonableness and proportionality are required in any stress test requirements.
THE EXCESSES

As in any significant crisis where legislation and regulations are adopted in response to a crisis, the end result is that reforms generally go too far. As William Blake said in The Marriage of Heaven and Hell: “The road of excess leads to the palace of wisdom...You never know what is enough until you know what is more than enough.” Without trying to detail each specific excess and with the acknowledgment that these regulatory initiatives also have had benefits, we suggest the following as being “too much of a good thing”:

Disproportional focus on capital.

A disproportional amount of time and effort has been spent on capital requirements. When one considers the time, expense and effort of developing Solvency II capital models, the more than six years the IAIS has devoted to develop a global group-wide capital standard, the Insurance Capital Standard (ICS) and the ongoing effort by US regulators to create a group capital calculation (GCC) for US insurance groups, one has to question the balance, even while acknowledging the benefits derived from some of these efforts. Moreover, the attempt to export Solvency II’s capital standards via equivalence assessments and the development of the ICS has injected harmful friction into key regulatory relationships and the IAIS regulatory apparatus, including revealing very significant fault lines between US and EU regulators. Moreover, attempting to create and impose a uniformed capital standard, impacting different countries with different accounting standards at different levels of development and under different circumstances has been characterized by some as an unattainable goal. It also seems to be a solution in search of a problem.

Recovery and resolution plans.

Recovery and resolution planning was initially introduced for systemically important insurers under the Dodd-Frank Act, but then took on a life of its own. In its simplest form, providing a roadmap of steps to take in the event an insurer faces material financial stress or when an insolvent entity must be liquidated without putting the whole system at risk is a useful exercise, and indeed is part of any sound management crisis response planning. In theory, this “living will” process provides an opportunity for a company to take a comprehensive look at its strategy and risk profile. However, the recovery and resolutions plans demanded of non-bank SIFIs and G-SIIs morphed into plans containing thousands of pages and costing tens of millions of dollars. (J.P. Morgan claimed that it devoted more than a million hours annually to preparing its Recovery and Resolution Plans for US, UK and EU requirements.) Although the cost of preparing these plans will vary depending on the size and complexity of the insurer, the costs are not insignificant and could easily aggregate $15 million - $20 million or more for larger insurers. Moreover, it is questionable whether regulators working on resolution plans for non-bank SIFIs and G-SIIs have sufficient time and expertise to understand them or even to review and comment on them before the next plan is submitted (as the plans originally were to be prepared annually). This created little direction or transparency for the companies subject to the requirement.

As Mike Tyson once observed, “everyone has a plan, until they get punched in the mouth.” Accordingly, one has to question whether the recovery and resolution planning being required will provide the road map for the crisis presented. Even if helpful in better understanding the “plumbing” of an insurer and how its corporate pieces fit together if there were a crisis, it is debatable whether the recovery and resolution plans required of insurers (to date) pass a cost/benefit analysis. There is now an effort to expand the requirement for recovery and resolution plans to at least all IAIGs. Regulators need to consider carefully who needs to prepare such plans and the requirements for such plans. This must include recognition of that fact that insurers are generally not susceptible to a “run on the bank” and therefore there is more time to react to an emerging crisis. Moreover, regulators need to recognize the patchwork of inconsistent laws governing the resolution of financial institutions and they need to acknowledge their own critical role in any recovery or resolution process. They need to consider how they will react and cooperate with each other in such situations. Far too little discussion has taken place on these important topics.
Systemically important insurers.

Designating certain insurers as systemically important nonbank financial institutions and global systemically important insurers was challenged from the beginning as unsupported by the facts and as a case of regulatory overreaction and political fallout from the financial crisis. Nevertheless, the IAIS on an international level and FSOC for the US dutifully went ahead identifying potential systemically important insurers and ultimately designated nine at the international level and four in the US. These insurers were then subject to enhanced prudential oversight, including the development of additional capital requirements, the preparation of recovery and resolution plans, the need to go through extensive stress and liquidity testing and other significant measurers.

FSOC was created by the Dodd-Frank Act to identify risks to the financial stability of the US that could arise from the material financial distresses or failure of large interconnected banks or nonbanking financial companies. As part of that authority, FSOC was directed to determine whether a nonbank financial company’s material financial distress, or nature, scope, size, scale, concentration or interconnectedness, could pose a threat to the financial stability of the US and, if so, to designate it as a SIFI and subject it to supervision by the Federal Reserve and enhanced prudential standards. As a result, FSOC designated three large insurance companies and GE Capital. As FSOC began its work, it was widely argued that unlike banks, insurance companies are far less likely to have any systemic impact on the financial system. However, as noted above, with the near collapse of AIG, it was inevitable that certain large insurance companies would be designated. Fast forward to 2018 and only Prudential remains designated as a non-bank SIFI. The other three non-bank SIFIs were de-designated. GE Capital sold most of its business; MetLife sued and was successful at the lower court level and the government’s appeal was ultimately withdrawn; and AIG dramatically reduced its assets and significantly derisked.

In response to these developments and further studies, many regulators have begun to reconsider systemic risk regulation. In an April 2017 Report to the President, the US Treasury questioned the entity-based designation approach and recommended going forward to prioritize an “activities-based” or “industry-wide” approach to address risks to financial stability. Moreover, the Report advocated that FSOC should work with the relevant primary financial regulators for that entity before considering any designation and to conduct a cost-benefit analysis and be more rigorous and transparent in any determination. Furthermore, the Report reiterated the requirement for a clear off-ramp process for designated nonbank financial companies to be de-designated. The Report referred to entity-based designation as a “blunt instrument” for addressing potential risks. The IAIS and US state regulators have followed suit and are now focused on activities-based systemic regulation.

The pivot away from an entity-based systemic regulation to an activities-based approach is reasonable. It also reinforces the argument that the original entity-based approach, at least for insurers, did not address a major systemic risk – a valuable, but expensive, lesson to have learned. An activities-based approach, however, also has a real danger of capturing a far greater number of insurers in the systemic regulation net. Accordingly, proportionality will be key.
WHAT THE FUTURE OF REGULATION MIGHT/SHOULD HOLD

It is of course much easier to look back and second-guess regulatory actions. It is far more difficult to propose a way forward and to do so in light of the emerging hot-button issues, including data and the digitization of the industry, InsurTech (and RegTech), emerging and growing risks, cyber, the Internet of Things (IoT), natural catastrophes, longevity and growing protectionism. The way forward requires consideration of the primary goals of insurance regulation and raises critical questions regarding how regulators prioritize their work and how they interact with one another, with the global industry and with consumers.

We offer below some thoughts and suggestions on these important questions and on how regulation might best move forward over the next ten years.

Establish a reasonable construct for regulatory relationships.

Relationships matter, and it is imperative for there to be careful consideration of how regulators organize their interactions and reliance on each other. As noted above, we have some examples in the form of the Solvency II equivalence assessment process, the NAIC’s Qualified Jurisdiction assessment process (under the US credit for reinsurance laws), the NAIC’s Accreditation process – for the states of the United States, the US-EU Covered Agreement, ComFrame, the IAIS and NAIC’s Memorandum of Understanding and the IMF financial sector assessment program (FSAP). Each of these provide varying degrees of assessment and regulatory cooperation/reliance.

These processes and protocols, however, have largely emerged on an ad hoc, unilateral basis and in some cases have had a whiff of imperial judgment about them, that may not be justified – and certainly is off-putting to counterparties. We would urge regulators to give careful consideration to the goals, guiding principles and the process for achieving greater levels of cooperation and reliance among global regulators.

We hope these efforts would include an appreciation that different approaches/systems can achieve similar results that no jurisdiction has a monopoly on good solvency regulation. There must also be respect for and recognition of local laws and a recognition that regulatory cooperation and accommodation will benefit regulators, the industry and consumers. Most importantly, regulators need to work together to develop confidence and trust in one another.

The IAIS first coined the phrase “supervisory recognition” in 2009. In March of that year, the IAIS released an “Issues paper on group-wide solvency assessment and supervision.” That paper stated that:

“The way forward requires consideration of the primary goals of insurance regulation and raises critical questions regarding how regulators prioritize their work and how they interact with one another, with the global industry and with consumers.”

“...supervisory recognition” in an effort to enhance the effectiveness and efficiency of supervision. Supervisory recognition refers to supervisors choosing to recognize and rely on the work of other supervisors, based on an assessment of the counterpart jurisdiction’s regulatory regime.” (emphasis added).

The paper noted the tremendous benefits that can flow from choosing such a path:
“An effective system of supervisory recognition could reduce duplication of effort by the supervisors involved, thereby reducing compliance costs for the insurance industry and enhancing market efficiency. It would also facilitate information sharing and cooperation among those supervisors.”

This is powerful. We urge global insurance regulators to take a step back and consider how they can enhance regulatory effectiveness and efficiency by taking reasonable and prudential steps to recognize effective regulatory regimes — even where these systems are based on different (perhaps significantly different) rules and principles, but which have a demonstrated track record of effectiveness.

As noted above, we have seen some efforts at supervisory recognition. These include Solvency II’s equivalence assessment process, the NAIC’s accreditation process for other US States, the NAIC “Qualified Jurisdictions” provisions for identifying jurisdictions which US regulators will rely on for purposes of lowering collateral requirements on foreign reinsurers, the EU-US Covered Agreement and the IAIS’s Memorandum on Mutual Understanding. Some of these processes are more prescriptive than others and have the danger of demanding that regulatory standards be virtually identical to be recognized. This should be avoided.

One size for all is not the way to go.

The alternative approach to recognition of different, but equally effective systems, is the pursuit of a harmonized, single set of regulatory standards for global insurers. This approach is much in vogue among some regulators, who assert the “need for a common language,” or for “a level playing field” or to avoid “regulatory arbitrage.” Some regulators also argue that common standards will lead to regulatory nirvana, where one set of rules will apply to all global insurers who will then be able to trade seamlessly throughout all markets.

There are, however, a variety of solvency and capital systems that have proven their effectiveness. These systems are not identical, and indeed they have some profoundly different regulatory structures, accounting rules and other standards such as the systems deployed in the EU (even pre-Solvency II), the US, Canada, Japan, Bermuda, Australia, Switzerland and others. Attempting to assert a signal system or standard ignores commercial, regulatory, legal, cultural and political realities.

Moreover, we question some of the rationale for pursuing uniform standards, including the need for a common language. We suggest that what is really needed is for regulators to continue to work together, to discuss their respective regulatory regimes and to develop a deep, sophisticated knowledge of how their regimes work. From this, trust will develop and from that a more effective and efficient system of regulation is possible. The engagement and trust building can happen within supervisory colleges. We have seen it emerge in the context of the EU-US regulatory dialogue. We saw it in the context of the EU-US Covered Agreement. No one, however, has made a compelling case for why one regulatory language is necessary to establish a close, effective working relationship among regulators.

Similarly, the call for a level playing field sounds good, but it is an amorphous, ambiguous term that is rarely, if ever, defined. Does the “playing field” include just regulatory capital requirements? If so, how about tax, employment rules, social charges? How about 50 subnational regulators versus one national regulator? Guarantee funds? Seeking a level playing field
can also be code for, “My system of regulation is heavier, more expensive than yours, so I need to put a regulatory thumb on the scales to make sure you have equally burdensome regulations.” This argument was made for decades in the debate surrounding the US reinsurance collateral rules. We hear it now regarding the burdens of Solvency II. It must be asked, however, whether it is the responsibility of prudential regulators to be leveling playing fields, or should their focus be solely on prudent regulatory standards for their markets.

Finally, the dark specter regulatory arbitrage is often asserted as a reason to pursue a single regulatory standard, such as the development of the ICS by the IAIS. But, one must ask if there is really a danger of regulatory arbitrage today among global, internationally active insurers? Yes, a vigilant eye needs to be kept for a weak link in the regulatory system, something the IMF FSAP system has sought to do, supervisory colleges can do and the IAIS is well equipped to do. But using regulatory arbitrage as an argument to drive the establishment of the same standards for all insurers, does not seem compelling.

Proportionality is required.

Often regulators roll out new regulatory initiatives with the phrase that the new rules will be “proportionate” to the targeted insurers. Too often it seems there is just lip service to this principle. Rarely is it defined – but it is tossed out in an attempt to say, “do not worry, the new rules will not be excessive.” Greater debate and greater commitment to this principle is needed. Clearly a key component of it must be a careful cost/benefit analysis of any proposed new standard. With a clear articulation of the perceived danger to be addressed – including the likelihoods and severity of impact and then a credible calculation of the attendant costs – economic and otherwise to industry and to regulators. In October 2017, the UK Treasury Select Committee published a report criticizing the PRA for its excessively strict interpretation of Solvency II and its negative effect on the competitiveness of UK insurers. The report concluded that the PRA had enhanced policyholder protection at the expense of increasing the cost of capital for UK insurers which adversely affected the ability of UK insurers to provide long-term investments and annuities. Although the PRA emphasized its mandate of prudential regulation and policy holder protection, the Treasury Committee reiterated its concern with how the PRA interpreted the principle of proportionality.

“There is a danger, however, that increasingly complex regulatory tools can create their own regulatory blind spots and that overly complex regulations can create a regulatory ‘fog of war.’”

Simplicity rather than complexity.

Over the past ten years, there has been a staggering increase in proposed and enacted regulatory requirements, many of which are catalogued above. There is a danger, however, that increasingly complex regulatory tools can create their own regulatory blind spots and that overly complex regulations can create a regulatory “fog of war.”

Andrew Haldane, Executive Director at the Bank of England, in August 2012, delivered a paper at a Federal Reserve Bank of Kansas City’s economic policy symposium, entitled “The Dog and the Frisbee.” He graphically laid out when less is really more by talking about two ways of catching a Frisbee: one can “weigh a complex array of physical and atmospheric factors, among them wind speed and Frisbee rotation” – or one can simply catch the Frisbee, the way a dog does. Complex rules, Haldane said, may cause people to manage to the rules for fear of falling in conflict with them. The complexity of the rules may induce people to act defensively and focus on the small print at the expense of the bigger picture.
Recognition of the importance of positive disruption through InsurTech, FinTech and innovation.

The general consensus is that the insurance industry is ripe for disruption because it has been slow (but is now working hard) to modernize in view of an array of innovative and technological advancements. Equally, regulators are trying to catch up with the rapid changes and are trying to understand the impacts through sandbox experiments and running separate regulatory models. The pace is fast and presents challenges for the regulators. Solvency and policyholder protection remain paramount, but cybersecurity, data protection, artificial intelligence and the digital revolution make advancements every day. Where this will lead is not clear. But changes are happening and regulators must work to understand the impact and need to calibrate regulatory rules to keep up with the industry and encourage innovation.

Regulation must be transparent.

Too often, regulation is drafted in times of crisis or behind closed doors by regulators believing they know better how to protect policy holders and how to prevent abuse of the system. As we have said, getting it right, matters. A strong and healthy industry is the best way to protect consumers and policy holders. Industry engagement is essential and acknowledging and actually incorporating industry’s views is critical. This is particularly true given the dramatic changes in the insurance sector, discussed above, and the need to adopt regulation to new economics, business practices and consumer needs and expectations.

Focusing on the complexity of the banking world, Haldane compared the 20 pages of the Glass-Steagall Act to the 848 pages of Dodd-Frank together with its 30,000 pages of rulemaking, and compared the 18 pages of Basel I to the over 1,000 pages of Basel III. The fundamental question is whether that additional detail and complexity really adds greater safety to the financial system or has just the opposite effect and significantly increases the cost. Haldane’s analysis provides compelling evidence that increasing the complexity of financial regulation is a recipe for continuing crisis. Accordingly, Haldane calls for a different direction for supervisors with “…fewer (perhaps far fewer), and more (ideally much more) experienced supervisors, operating to a smaller, less detailed rule book.”

Although Haldane’s analysis and discussion focuses on the banking system, his assessment and recommendations should be considered carefully by global insurance regulators. The sheer volume and complexity of rules, models and reports that flood into regulatory bodies raise the real question of who reviews this information, who really understands it and, worst of all, does a mountain of detailed information create a false confidence that regulators have good visibility into the risks – particular the emerging risks – that insurers are facing. A real danger exists of not seeing the forest for the trees.

Regulation should promote competitiveness rather than protectionism.

At a time when competition has been growing not only from within the established companies but also more importantly from outside the traditional companies, protectionism will only inhibit growth and stifle better understanding of risk in a rapidly changing business environment. The goal must be to make the industry more competitive and to courage transfer of innovation and create better ways to address risk, distribution of products and climate changes. Protectionism will only limit the potential of growth of the industry and is both shortsighted and self-defeating.
CONCLUSION

The last decade has been a remarkable and important epoch for the insurance industry and its regulators. The financial crisis, increased globalization, use of data, technology advancements and emerging new risks have all driven the regulatory agenda. Without doubt, the financial crisis has been the dominant force throughout this period and the regulatory reaction to it is what we have largely focused on in this paper.

As we look ahead, many of these issues will continue to advance and challenge regulators and the industry. In light of this, we have sought to illuminate some of the macro regulatory trends of the past ten years and to consider how these developments might guide the regulatory agenda over the next ten years. We hope that this review will stimulate, even provoke, additional conversations about regulatory priorities and the principles that might usefully guide the development of further regulatory standards. Most importantly, we urge regulators to:

- Incorporate lessons learned from the last decade and build regulatory institutions and protocols that accommodate different, but effective, regulatory regimes.
- Advance mechanics for cooperation, including Memoranda of Understanding, bilateral or multi-lateral agreements (such as the EU-US Covered Agreement) and other statutory or regulatory regimes for the recognition of other supervisors. These various forms of ‘supervisory recognition’ will drive efficiencies for both regulators and the industry – to the ultimate benefit of consumers. This approach will also lead naturally to convergence and sharing of best practices.
- Consider the legal, political and commercial realities of trying to force a single standard on global businesses with profound differences in accounting, capital, risk management and policyholder protections systems.
- Apply proportionality in fact, not just in theory – and think through what that really means.
- Focus forward, concentrating on priority issues that are emerging. There is always a tendency to fight the last war. The next crisis will most likely not be the same as the last one, but the tools being developed must be flexible and adaptable to withstand the next major challenge.
- Confront the growing threat of protectionism.
- Continue to engage the industry on critical issues and recognize that a healthy and successful industry is one of the best protections for policyholders.
- Recognize the importance of the insurance industry to the global economy, with all of its capabilities and resources and to help bring these capabilities to those who need them most.
- Acknowledge the benefits and challenges provided by emerging technologies. The role of the regulators must be to understand, validate and embrace those changes as appropriate. This will require substantial regulatory resources and attention.

Finally, we urge regulators to reflect on their considerable regulatory successes – including their performance during the financial crisis. It is a track record of which to be proud. And then, it is time to turn back to the regulatory agenda for 2018-2028.
ABOUT US

DLA Piper is a global law firm with lawyers located in more than 40 countries throughout the Americas, Europe, the Middle East, Africa and Asia Pacific, positioning us to help clients with their legal needs around the world.

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