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CILA II Seminar
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Understanding the Global Regulatory Horizon

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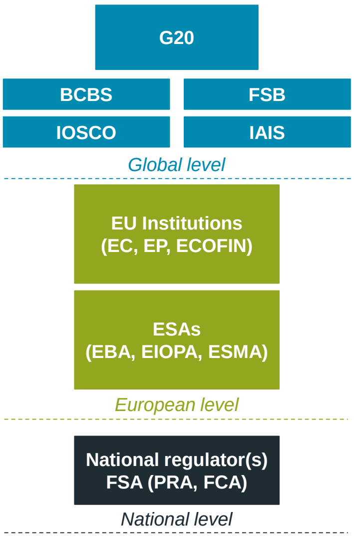
Setting up the Regulatory Stage

International regulatory architecture

Key drivers of regulatory change



Regulatory roles evolve

- Regulatory direction is increasingly set by the **G20**.
- Global standards/recommendations are **non-binding, but** mounting **political pressure** and increasing use of both **implementation assessments** and **peer reviews** motivate compliance.
- Most **EU-led** reforms have been driven by the **international commitments, while the EU** has also gone beyond the scope of the G20 on some issues.
- **European Supervisory Authorities (ESAs)** play a key role in all EU legislative proposals.
- **Supervision** is still largely a national responsibility, but **change is afoot in banking** and there is a move across the board towards a **single EU rulebook**.
- The new structures and responsibilities, coupled with the crisis-fuelled spotlight that has been trained on financial services, mean that regulation and supervision are **increasingly politicised**.

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Global Systemically Important Insurers (G-SIIs)

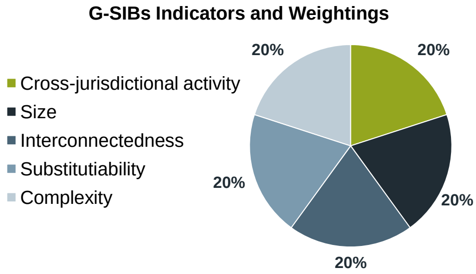
How do you know a G-SII if you see one?

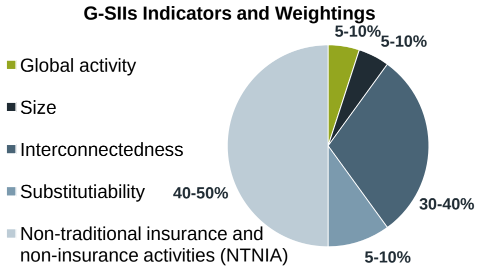
The IAIS approach to identifying global systemically important insurers

Methodology

I. Data collection → II. Indicator-based assessment → III. Supervisory judgement

G-SIBs vs. G-SIIs





Possible policy measures:

- Higher loss absorbency
- Restrictions on NTNIA
- Structural measures e.g. separate legal structure, limits on cross-subsidies within a group

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Focus on non-traditional & non-insurance activities

What does this mean in practice?

"The potential for systemic importance is only considered to arise in any non-traditional or non-insurance activities which may be undertaken by a small number of insurers."

-- IAIS

Scope

Non-traditional insurance:

- Alternative risk transfer, including insurance-linked securities
- Financial guarantee insurance
- Finite reinsurance
- Purely synthetic investment portfolios
- Cascades of repos and securities lending
- Scope and scale of activities beyond insurance remit

Non-insurance:

- CDS/CDO underwriting
- Capital market business
- Banking, including investment banking and hedge fund activities
- Third-party asset management
- Industrial activities

Indicators

Non-policy holder liabilities, non-insurance revenues	Weighting of 6.7% to 8.3% each (40-50% for NTNIA overall)
Derivatives trading (CDS)	
Short-term funding	
Financial guarantees	
Variable annuities	
Intra-group commitments	

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Key implications for insurers

Consultation responses and impact analysis

Product Portfolio	•Increased demand for aggregate analysis of product portfolio •Assessing the merit of disposing of investments and/or business lines to avoid G-SII status, including variable annuities •Opportunity cost of operating in high-concentration markets e.g. credit, aviation, marine
Risk mitigation	•Hedging derivatives, pooling, separate accounts typically are perceived as risk mitigants •The IAIS's weightings for derivatives or size do not account for this view
Data	•Data call demands – supplying public and non-public data •Need for analysis on both relative and absolute basis; data normalisation
Appeals	•Scope for discussions between IAIS analysis team, group supervisors and G-SII candidate
Pending	•A list of G-SIIs to be published by April 2013, **if any G-SIIs are identified** •Unclear if G-SII candidates will be benchmarked against G-SIBs •Methodology weighting to be revisited, including treatment of reinsurance and possibly NTNIA weighting •Role of regulatory judgment and cooperation to be clarified

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Initiatives beyond G-SIIs with impact on NTNIA

Shadow Banking

Regulatory Approach

•**FSB tasked with 5 work streams**:
1) banks' interactions with shadow banking entities
2) MMFs
3) securitisation
4) securities lending and repos
5) other shadow banking entities

•Approach in **Europe** is broadly in line with that of the FSB.
•Insurers' and investment firms' role as lenders/investors is often constrained by **investor protection.**
•Further regulation may have an impact on the **cost and appeal of NTNIA**, in line with G-SII objectives.

Securities lending and repos

•Enhanced **prudential regulation**
•Limits on maturity of investments where cash collateral can be used
•Introduce minimum margin or haircut requirements to **mitigate procyclicality**
•Improving **market infrastructure** for secured funding markets

Banks' interactions with shadow banking entities

•**Limits on the size and nature** of a bank's exposures to shadow banking entities
•**Higher risk-based capital requirements** for banks' exposures to shadow banking entities
•**Consolidation of shadow banking vehicles**/ funds that are sponsored or operated by banks

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Initiatives beyond G-SIIs with impact on NTNIA

OTC Derivatives Regulation

EMIR

- Standardised OTC derivative contracts to be cleared
- All OTC derivative contracts to be reported to trade repositories
- Non-cleared contracts to be subject to strengthened risk management requirements, including the need to collateralise positions

MiFID II/ MiFIR

- Standardised OTC derivative contracts to be traded on an electronic platform
- New trading venue: Organised Trading Facility
- Pre and post trade transparency requirements extended to derivatives and bonds

Potential impacts for insurers

- **Liquidity challenge**: counterparties will need to mark-to-market positions on daily basis; daily margining and exchange of cash flow.
- **Capital treatment:** questions remain on assessment of counterparty credit risk for solvency capital calculations.
- **Rising cost**: increased cost of trading derivatives and derivatives products overall
- **More reporting**: increased scope, data requirements, frequency (e.g. real time, daily)
- **More choices to be made**: direct client, indirect client, trading venues/platforms

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The Consumer Protection Agenda

More product governance regulation

	2011	2012	2013	2014 / 2015
UK initiatives				
Product Intervention	Product Intervention discussion paper statement and feedback			
Retail Distribution Review (RDR)		RDR entry into force (31 December 2012)		
Mortgage Market Review (MMR)	Consultation on MMR		MMR entry into force	
Structured products		Structured products review completed		
Payment Protection Insurance (PPI)	PPI proposed guidance			
Packaged bank accounts	Packaged bank accounts consultation	Packaged bank accounts final rules and further consultation		
FCA/ FSA product powers	FCA approach document	Transition to internal "Twin-Peaks" model; FCA product powers drafted	Full transition from FSA to FCA	
With-profit policyholders		FSA Policy Paper: "Protecting with-profit policyholders"		
Traded Life Policy Investments	FSA introduces partial ban			
Unregulated collective investment schemes		FSA introduces partial ban		
EU initiatives				
Packaged Retail Investment Products (PRIPs); Revisions to Insurance Mediation Directive (IMD II); Review of UCITS (UCITS V)		Proposals (3 July 2012)	Implementation	Entry into force
Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments(UCITS VI)		Proposal (26 July 2012)		
Markets in Financial Instruments Directive/ Regulation (MiFID II/ MiFIR)	MiFID II/ MiFIR proposal (20 November 2011)		MiFID II / MiFIR implementation (Q1 2013*)	MiFID II/ MiFIR entry into force*

* Best estimate based on information available

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New approach to product regulation

Intervention at every stage of the product lifecycle

The New Approach

- Regulators to address failures in product design, rather than intervening at evidence of sales failures
- The UK is at the forefront of the move towards scrutinising products from the early stages of their lifecycle: " We will look at the product lifespan from the boardroom to the point of sale".(Martin Wheatley, Sept. 2012)
- Clear will to harmonise product regulation in the EU, but national-level differences remain

Areas Coming Under Regulatory Scrutiny

Product Strategy	Target Market	Distribution	Financial Promotions	
Stress Testing	Sign off & Implementation	Pricing and Transparency	MI & Post Sales Service	Exit Barriers

Ongoing review (e.g. feedback and root causes, post implementation reviews)

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Product Governance

Key themes and challenges

Key themes

Strategy	Target Market
Lifecycle Review	Management Information
Distribution	Communication

Key challenges

Economic and regulatory environment:

- Affects customer needs and attitude to risk
- May affect product availability and strategy
- Influences the firm's conduct risk exposure
- Need to change Management Information (MI)
- More regular reviews of product suitability
- More regulatory powers and propensity to ban products

Key areas for attention:

- Firms need to define their target market better.
- Firms need to undertake robust product reviews.
- Firms need to tailor products at early stages to demonstrate "consumers get a fair deal".
- Firms need to consider ongoing risk and develop capacity to deliver appropriate and timely MI.

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The FCA's competition objective

The FCA's powers and approach in safeguarding competition

- The Financial Services Bill adds competition to the FCA's operational objectives.
- Additional to the product intervention agenda, this is indicative of the FCA focus.
- Firms may need to contribute enhanced data and analysis on the source of their profits and their competitive positioning e.g. market share, M&A decisions, relationship with distributors, product promotions.

The FCA and the OFT

"The FCA may ask the Office of Fair Trading (OFT) to consider whether a feature, or combination of features, of a market in the UK for financial services may prevent, restrict or distort competition in connection with the supply or acquisition of any financial services."

-- The Financial Services Bill, 2012

The FCA will consider:

- Consumers' needs, including for information
- Ease of switching service providers
- Barriers to entry
- How far competition is encouraging innovation

The FCA will seek to ensure:

- Competition on better services, value and product choice
- No firms sustaining excess profits
- Innovation in products and delivery
- Success measured by responsiveness to consumer needs

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Data Regulation

Data management, governance and reporting

More than merely a "banking issue"

Global	•SIE progress report finds data aggregation capabilities of many SIFIs inadequate. •Revised Insurance Core Principles (Oct 2011) include more stringent data requirements around quality/ frequency of information reports. •ComFrame: IAIG should have high quality relevant data for ERM. •Identified G-SIIs are likely to be subject to further requirements similar to those being introduced for G-SIBs e.g. Common Data Template/ international risk data principles.
EU	•EIOPA and ESRB are increasingly focused on data. •Most new EU legislative initiatives have a data element (e.g. Solvency II, Short Selling Regulation, MiFID II).
UK	•PRA will verify insurers' data and risk management systems (including on-site inspections). •Firms expected to submit high quality data. •FPC will have own data requirements for macroprudential surveillance.

Key implications for insurance firms

Accountability, oversight and new IT infrastructure

Impact on insurers

- Data reporting frequency will increase and firms will need to report to an increasing number of regulatory bodies.
- Changes to IT infrastructure will be required to collect, collate, aggregate and report increasingly large amounts of data.
- Increasing requirements for data governance including the need to build in quality assurance controls
- Firms will need robust systems capable of delivering quick response to ad-hoc data requests.

Impact on actuaries

- Changes to data inputs for risk models will impact the way actuaries calculate risk.
- Expectation that actuaries will have more prominent role in:
  - Providing internal challenge of poor quality data
  - Monitoring implementation of corrective actions required by regulators

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Questions and Answers

Deloitte.