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Transactional Trends in the Global Insurance M&A Market

By Nicholas F. Potter and Leigh A. Van Ostrand

Corporate mergers and acquisitions are having an important impact on the global insurance market in 2012. These transactions take place against a backdrop of regulatory changes, continuing low interest rates, distress in Europe and, for some financial institutions, the obligation to repay government bailout money. These factors have driven insurance companies, other financial institutions and private equity and hedge fund asset managers to look to the M&A market as they divest non-core assets, consolidate operations and reconsider doing business in certain geographic areas. This M&A activity has been coupled with other transactions across the capital spectrum, including reinsurance and capital markets transactions, as insurance companies seek to manage their own capital needs in the most efficient and effective manner possible.

This article surveys transactions that reflect these trends, and considers what might lie ahead in the global insurance M&A market.

Repayment of Government Aid and Other Fallout from the Financial Crisis

Financial institutions that received government assistance during the crisis are divesting assets in an effort to pay governments back. Examples abound. In the United States, AIG sold a number of its businesses after receiving government aid during the crisis, including, among others:

- AIG Finance (Hong Kong) Limited to China Construction Bank in 2009;
- American Life Insurance Co. ("Alico") to MetLife in 2010;
- AIG Star Life Insurance Co., Ltd. and AIG Edison Life Insurance Company to Prudential Financial, Inc. in 2011; and
- Nan Shan Life Insurance Company, Ltd. to Ruen Chen Investment Holding in 2011.

AIG also spun off its Asian life insurance business, AIA, in October of 2010. AIA is now a player itself in M&A transactions, agreeing in September 2012 to purchase a stake in Sri Lanka-based Aviva NDB Insurance Plc and in October 2012 to acquire ING's Malaysian insurance subsidiaries.

AIG has made great progress repaying the U.S. government. In May 2011 the Department of the Treasury began selling the shares of AIG stock that it received in exchange for its financial aid. Treasury announced in September 2012 that, so far, it and the Federal Reserve Bank of New York have earned a combined profit of approximately $15.1 billion (giving effect to the most recent offering) from their commitment to AIG. Treasury still holds about 16% of AIG's stock.

In addition to AIG, The Hartford Financial Services Group, Inc. received U.S. government aid during the financial crisis. The Hartford repaid this money in 2010, but its business model, in particular its emphasis on the variable annuity business, has caused continuing difficulties. John Paulson, manager of one of The Hartford's shareholders (hedge fund Paulson & Company), pressured The Hartford to spin off its P&C business in order to unlock value. The Hartford instead announced that it would divest certain assets in an effort to

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Why FIO Matters

By Ethan T. James and Amanda Greenwold Wise

Introduction and Background

The Federal Insurance Office stands at the center of a new national and international insurance regulatory world. Created by Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203), the Federal Insurance Office, is not the most powerful presence at the Financial Stability Oversight Council, nor at the International Association of Insurance Supervisors, nor does it hold a lofty perch within the walls of the Department of the Treasury. Despite lacking a true regulatory mandate, despite efforts by many to dilute the functions of the office, and despite the statutory limits of the Office's power, FIO is in an unparalleled position among insurance-related entities to participate in the unfolding of this new post-crisis world.

The FIO did not begin auspiciously. As early as 2008, in the Blueprint for Modernizing Financial Regulatory Structure produced under Secretary Paulson, Treasury advocated for more extensive federal participation in insurance regulation by proposing an optional federal charter for insurance companies as an alternative to the system of state insurance regulation. The optional federal charter would have created a system similar to the dual state/federal banking system that developed in the 19th century. By late 2009, however, the Obama Administration and its allies in Congress found themselves pushing for a more comprehensive set of financial regulatory reforms. Supporters of financial reform believed that a proposal for an optional federal insurance charter would jeopardize the chance for passage of broader reform. The optional federal charter was never proposed, either by the Administration or by members of Congress as part of this package of reform legislation. Instead, these reforms, which became Dodd-

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Frank, opened a new window for federal participation in insurance, creating FIO as a limited-purpose office, to monitor all aspect of the insurance industry; to recommend to FSOC that it designate certain insurers as systemically important; and to coordinate federal efforts and develop federal policy on international insurance issues.[1]

Although there was consensus from the outset that FIO would be housed in Treasury, there was some debate as to the stature of the office within the Department. Initially, some in the Department and in Congress proposed that the office be headed by a Deputy Assistant Secretary, a political position. In the end, however, the Act directed that FIO Director be a member of the Senior Executive Service, a high-ranking senior civil servant reporting to the political ranks within the Department.[2] As a result, today the FIO Director reports to the Deputy Assistant Director for Financial Institutions, on up to the Assistant Secretary for Financial Institutions, the Undersecretary for Domestic Finance, the Deputy Secretary, and, finally, to the Secretary. Insulating the position from politics also had the effect of moving it down the chain of Departmental reporting.

FSOC Responsibilities

Among his other responsibilities, the Director serves as a non-voting member of the FSOC. Thus far, this position has given the Director access to FSOC deliberations in their entirety, as the voting members of the FSOC have never excluded the non-voting members from FSOC proceedings (as is their right under certain circumstances).[3] The Director and his staff also participate in staff-level discussions and workstreams with other FSOC member agencies. With the other two "insurance members" of the FSOC – the independent member with insurance expertise and the member selected by the state insurance commissioners – FIO is leading efforts to determine which insurers will move from "Stage 2" to "Stage 3" in the designation process.[4] So far, AIG is the only insurer to confirm it has been moved to Stage 3, but it may have company if the FSOC meets again, as expected, in October. To varying degrees, the FIO and the other FSOC insurance members continue to work to distinguish the insurance industry from other types of non-bank financial institutions for FSOC purposes. While FIO and its Director can work within the Treasury to influence the Secretary and other Treasury FSOC personnel, the FSOC vote ultimately belongs to the Secretary. FIO has to fight to be heard over the din of the Secretary's other advisors, many of whom came from the world of banking, or from other types of non-bank financial institutions, like hedge funds and asset managers.

> Despite lacking a true regulatory mandate, despite efforts by many to dilute the functions of the office, and despite the statutory limits of the Office's power, FIO is in an unparalleled position among insurance-related entities to participate in the unfolding of this new post-crisis world.

The Federal Reserve Board's recent Basel III implementation proposals highlight the difficulties insurers have in complying with bank standards. Although several insurers are organized as bank holding companies or as savings and loan holding companies, their risk-based capital requirements differ from those of banks. An insurer's investment horizons and risk allocations differ from a bank's. Many insurers prepare financial statements using statutory accounting principles, and may not even prepare GAAP financial statements.

FIO is currently understaffed, reducing its ability to provide views to balance generally bank-centric thinking within some other FSOC

1 Also, FIO has authority to monitor consumer access to insurance products; to assist the Secretary in administering the Terrorism Risk Insurance Program; to consult with the states on insurance matters of national and international importance; and to carry out such other duties as the Secretary may assign it. 31 U.S.C. 313 (a).

2 31 U.S.C. 313 (b).

3 Dodd-Frank Section 111 (b)(3).

4 As described in its rule of April 3, 2012, "Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies," (77 Fed. Reg. 21637) non-bank financial institutions meeting certain statistical thresholds automatically move from Stage 1 to Stage 2 in the designation process (other non-banks can be moved from Stage 1 to Stage 2, but not automatically). In Stage 2, the FSOC gathers and considers information about specific financial institutions. If the FSOC believes after a Stage 2 analysis that the institution may be systemically important, that institution will be moved to Stage 3, and the institution itself will be asked to provide data for FSOC analysis.

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agencies. And, while FSOC appears open to some limited tailoring for insurance providers, as of yet the FSOC has not chosen to create a distinct analytical process for insurance institutions.

Compounding the problem for the insurance industry is the exclusive authority of the Federal Reserve Board to determine how to implement heightened supervision for companies designated as systemically important financial institutions, or SIFIs, by the FSOC (although the FSOC can make recommendations to the Board). The Federal Reserve Board's proposed rule for enhanced supervision of non-banks published for comment on January 5, 2012 made no distinction between insurance institutions and other types of non-banks, despite permission in the statute for different prudential standards for different types of financial institutions.[5] The Federal Reserve Board's proposal disappointed the insurance industry, which had argued before the Board and other FSOC members that a single-application supervisory standard would not fit with insurers' investment and risk profiles, accounting standards, and state regulatory requirements. In any case, it is largely out of the hands of FIO, and of Treasury, how the Federal Reserve Board chooses to implement its heightened supervision of designated institutions.

International Responsibilities

Despite the importance of the FSOC and its work, FIO's immediate challenges will arise in the international arena. Congress authorized FIO to "coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters, including representing the United States … in the International Association of Insurance Supervisors … and assisting the Secretary in negotiating covered agreements." Dodd-Frank defines "covered agreements" as written bi- or multi-lateral agreements between the United States and foreign entities on prudential matters relating to the business of insurance.[6]

Currently, FIO is part of international efforts to develop several proposals that have the potential to result in covered agreements. FIO joined the International Association of Insurance Supervisors ("IAIS") in late 2011, and took a seat on the Executive Committee in early 2012. This is noteworthy because it is the first time that the United States has been represented by a federal government actor at the IAIS. Historically, the U.S. delegation has been confined to National Association of Insurance Commissioners staff, joined by a limited number of state insurance regulators working closely with the NAIC. Indeed, to take its place on the Executive Committee, FIO displaced a state insurance commissioner (Christina Urias of Arizona) in order to hold the official U.S. delegation at three members. In October 2012, FIO became chair of the IAIS Technical Committee, the group charged with developing IAIS standards.

FIO has been a part of IAIS efforts to identify global systemically important insurers , or GSIIs. As charged by the G-20, the Bank of International Settlements has undertaken a number of different projects designed to promote global financial stability. Through the Financial Stability Board, it tasked the IAIS with developing a system to identify insurers whose failure or financial difficulty could result in harm to the financial systems of multiple nations. In contrast to the U.S. domestic process for identifying SIFIs, the IAIS has determined that it will collect data from several large insurers, and derive a system for identifying GSIIs based upon the data received. However, both industry and regulators in the United States are concerned about the confidentiality of this data.

To date, IAIS has sent two data calls to approximately fourteen U.S. institutions, most recently in August 2012. The information responding to the first data call was collected and forwarded to the IAIS by the State of Connecticut, which relied on state data privacy and other laws in performing this function. In the second data call, FIO is serving as the U.S. point of contact. Relying on its authority to collect and analyze data, as well as its charge to represent the U.S. at the IAIS, this data call will test FIO's ability to protect any confidential information gathered. The GSII process is particularly critical, as it will be one of the first demonstrations of how FIO interprets its charge to "represent" the U.S.

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5 77 Fed. Reg. 529 (Jan. 5, 2012); Dodd-Frank at Section 115 (a)(2)(A).

6 31 U.S.C. 313 (r)(2).

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in the international body: FIO will have to balance its stewardship of international financial stability and its advocacy of the United States and its insurance industry.

The IAIS designation and supervision project could ultimately be memorialized in a covered agreement. This may give FIO the opportunity to employ one of the most controversial provisions of Dodd-Frank – the power to preempt state law under certain conditions. If a state does not bring its law into compliance with the terms of the agreement, and if that results in discriminatory treatment of a non-resident insurer, FIO may preempt the laws of the state and enforce the terms of the covered agreement.[7] In granting FIO this preemptive power, Congress took a step towards solving one of the problems that has vexed many, particularly abroad, by guaranteeing that each insurance-regulating jurisdiction at least minimally adheres to internationally-agreed prudential norms.

FIO is also working with the IAIS and others to create a common framework for supervision of internationally-active insurers, a project known as "ComFrame." ComFrame would have supervisors around the globe work together to supervise internationally active insurance groups and close regulatory gaps. While the details of ComFrame have yet to be articulated, FIO has expressed its support for the concept of international regulatory convergence.

Another major international project for the FIO is Solvency II, although the immediacy of this project has diminished recently. Solvency II is a review of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of European Union-wide capital requirements and risk management standards that will replace the current solvency requirements. The European Commission will then study non-European insurance regimes to determine their "equivalence" with the EU standard.

FIO and the EU agreed in early 2012 to create bilateral working groups to discuss a few major areas of insurance regulation, including data privacy and reserving. FIO and the EU have recently produced these reports for public comment. These reports discuss the differences and similarities in the U.S. and European approaches to insurance regulation. FIO believes that the reports will form the basis for the EU to determine that the U.S. system is equivalent to the EU standards, allowing the United States to avoid a unilateral EU conclusion about the nature and adequacy of the U.S. regulatory system. This belief is based largely on the conviction that the EU, as a matter of practical economics, cannot help but determine that the U.S. system is equivalent. A decision based on a dialogue between Europe and the United States will help both parties – it allows the EU to say that it explored the issues raised by the American systems, and allows the U.S. to claim that it did not submit its system to the judgment of foreign governments.

Treatment of Data

As a result of its international work, as well as its FSOC duties, FIO is at the center of federal efforts to obtain and analyze insurance-sector information. The financial crisis, and in particular the situation at AIG, highlighted to the federal government how little information it had about the insurance sector. As a result, Dodd-Frank gave FIO authority to require insurers to submit any data the FIO may "reasonably require" to carry out its duties (although FIO must first ascertain that it cannot get the information it needs from a public source or from a functional regulator).[8] FIO may enter into information-sharing agreements, analyze and disseminate data, and issue reports on all lines of insurance except health insurance. FIO may even, after coordinating with insurance regulatory agencies and upon a finding by the Director, compel information by subpoena.

Dodd-Frank established the Office of Financial Research to lead efforts to collect and analyze data for FSOC use.[9] Because of political and bureaucratic obstacles, however, the Office of Financial Research has not yet been able to provide these services on any comprehensive basis. The various other FSOC member agencies have therefore done much of their own data collection and analysis, mostly using regulatory data

7 For example, the U.S. might agree to risk-based collateral requirements for all reinsurers without regard to domicile. State laws requiring 100% collateral for non-domiciliary reinsurers would not comply with the terms of such a covered agreement, which would result in harm to a non-domiciliary reinsurer.

8 31 U.S.C. 313 (e).

9 Dodd-Frank at Section 152 *et. seq.*

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already at hand. But since the federal government has almost no regulatory data for insurance companies, FIO has been forced to do more work on collection, data sharing, and data analysis than its FSOC counterparts, and more than contemplated by the drafters of Dodd-Frank.

However, without the explicit confidentiality provisions Dodd-Frank gives the Office of Financial Research, FIO may not be able to protect the data it collects from disclosure under the Freedom of Information Act ("FOIA").[10] FOIA requires federal agencies, upon request, to disclose information in their possession, although agencies may withhold documents falling into a few protected categories. FIO data reasonably could be expected to fall into one FOIA exemption – the confidential business information exception – and might possibly fall under the supervisory exemption.[11] If documents or data requested by the public contain commercially or financially confidential information (as is likely in the case of any FIO data call relating to its monitoring of the health of the insurance sector), FIO can withhold from disclosure at least that portion of the submission which contains the business-sensitive information.

Applying the supervisory exemption may be more difficult. As Dodd-Frank makes clear, FIO does not have general supervisory or regulatory authority over the business of insurance.[12] If FSOC designates any insurers as systemically important, those companies will be subject to heightened supervision by the Federal Reserve Board. If FIO prepares reports for the Federal Reserve Board as the regulator of those entities, those reports and the information underlying them may be exempted from public release as examination, operating or condition reports for the use of a supervisory agency.

Another application of the supervisory exemption could arise if FIO ever preempts state law, as permitted under the limited circumstances discussed above. In that case, documents relating to that law and that process may be considered supervisory documents since FIO would be enforcing prudential standards. Finally, Dodd-Frank is explicit that disclosure of information to FIO does not constitute a waiver of a legal privilege or by a confidentiality agreement.[13]

Conclusion

Federal involvement in the insurance industry is here to stay, and it is likely to increase. Although thus far AIG is the only insurer to move to Stage 3 of the SIFI designation process, it is generally assumed that at least a small handful of insurers will ultimately be designated by the FSOC. It only takes one to cause the Federal Reserve Board to apply capital standards and other prudential regulation to an insurance company. Similarly, although the number of savings and loan holding companies in the insurance industry is dwindling, when Basel III standards become effective they will provide another entrée to the insurance industry for federal regulators. MetLife, a bank holding company by virtue of its ownership of a bank (which it is in the process of divesting), experienced first-hand the challenges facing an insurance company measured using banking standards when it participated in the Federal Reserve Board's stress test exercise earlier this year.

In each of those circumstances FIO has a unique and somewhat undefined position. That, along with the statutory authority to represent the U.S. insurance industry on international matters, strongly demonstrate that the industry would be well-served to help guide the evolution of FIO's role, and to help FIO play that role as effectively as possible. Industry participants, whether individual companies or associations, should actively look for ways to engage and assist FIO. In addition, the NAIC has an important role to play in this process. Expanded federal regulation of insurers is on its way, and it is in everyone's interest to help ensure that the related policy decisions have a solid underpinning of practical input.

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10 5 U.S.C. Section 552.

11 5 U.S.C. 552 (b)(4) and (b)(8).

12 31 U.S.C. 313 (k).

13 31 U.S.C. 313 (e)(5).

Expansion of U.S. Sanctions Against Iran and Syria

By Satish M. Kini, Carl Micarelli and Samuel E. Proctor

On October 9, 2012, President Obama issued Executive Order 13628, which prevents foreign subsidiaries of U.S. companies from engaging in most transactions with Iran. This Executive Order applies the United States' existing comprehensive sanctions against Iran to entities that are owned or controlled by U.S. persons. Until now, foreign firms that were owned or controlled by U.S. parents were generally free, under U.S. law, to trade with Iran, provided the U.S. parent did not facilitate the transactions.

Executive Order 13628 implements a key provision in the recently enacted Iran Threat Reduction and Syria Human Rights Act of 2012 ("ITRSHRA"). That law, which was signed by President Obama on August 10, 2012, contains numerous provisions that significantly broaden the reach of and strengthen U.S. sanctions against Iran and, to a lesser extent, Syria. These provisions – which impose new disclosure obligations on issuers of U.S. publicly traded securities and expand the range of actions that may be imposed on foreign firms that do business with Iran – introduce new compliance burdens and complexities for many U.S. and international firms. We discuss the new Executive Order and some of the principal provisions of ITRSHRA below.

Liability of U.S. Parents for Iran-Related Transactions of Foreign Subsidiaries

Under Executive Order 13628 and Section 218 of ITRSHRA, foreign entities that are "owned or controlled" by U.S. persons are prohibited from knowingly engaging, directly or indirectly, in Iran-related transactions to the same extent as U.S. persons. The Act defines "ownership or control" to mean (i) holding more than 50 percent of the equity interests by vote or value in an entity; (ii) holding a majority of seats on the entity's board of directors; or (iii) otherwise controlling the actions, policies or personnel decisions of the entity. The requisite "knowingly" standard can be met either through a showing of "actual knowledge" or by establishing that the entity "should have known" of the conduct at issue.

The U.S. parent that owns or controls a foreign entity that violates this provision may be subject to penalties as if it had violated the sanctions itself. As under the existing Iran sanctions, civil money penalties may be up to $250,000 per violation or twice the value of the transaction. There is a safe harbor, however. Penalties do not apply if the U.S. person that owns or controls the foreign entity "divests or terminates its business with the entity no later than February 6, 2013." Read literally, this provision seems to require the U.S. person to divest itself of the foreign subsidiary, rather than simply to cause the foreign subsidiary to cease its Iranian business, to benefit from the safe harbor. This may reflect an assumption that the 60-day period between the enactment of ITRSHRA and its implementation by Executive Order 13628 gave companies sufficient notice to wind down their foreign subsidiaries' business in Iran.

Enhanced Disclosure Requirements for SEC Filers

Under ITRSHRA, companies that file public reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934 are subject to enhanced disclosure requirements regarding Iran-related transactions. Beginning on February 6, 2013, affected issuers must disclose in their quarterly or annual filings if they or their affiliates "knowingly" engaged in (i) activities, such as transactions related to Iran's energy sector, that are sanctionable under certain pre-existing Iran sanctions laws, namely the Iran Sanctions Act of 1996 ("ISA") and the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 ("CISADA"); (ii) transactions with Iranian Specially Designated Nationals ("SDNs") designated for supporting activities related to terrorism or proliferation of weapons of mass destruction ("WMDs"); or (iii) transactions with the Government or Iran or entities owned or directly or indirectly controlled by the Government of Iran, including persons for which there is reasonable cause to believe are acting on its behalf.

The required disclosures must include (i) the nature and extent of the activity or transaction; (ii) the gross revenues and net profits, if any, attributable to the activity or transactions; and (iii) whether the issuer or its affiliate intends to continue the activity or transaction. If the issuer or affiliate makes such a disclosure, it must separately inform the SEC, which must then post the information on the Internet and inform the President and Congress. On receipt of a disclosure, the President must initiate an investigation and determine within 180 days whether to sanction the issuer or its affiliate.

Expansion of Existing Sanctions Regime

ITRSHRA also expands various pre-existing Iran sanctions regimes. It requires that certain sanctions be imposed on foreign companies that

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engage in certain types of business with Iran; narrows the exemptions available to conduct business with Iranian financial institutions; and restricts the President's authority to grant waivers from the prohibitions.

Under prior law, the President was required to impose three of nine possible sanctions against persons and entities that engaged in sanctionable activities. ITRSHRA adds three new possible sanctions to this list and requires the President to impose five of the 12 sanctions on a finding of a sanctionable activity. The three new possible sanctions are:

- U.S. persons may not invest in or purchase significant amounts of equity or debt instruments of a sanctioned person.
- Corporate officers, principals or shareholders with controlling interests in a sanctioned person may not travel to, and are excluded from, the United States.
- Available sanctions may be imposed individually on the principal executive officers of sanctioned persons, or on persons performing similar functions to principal executive officers.

Pre-existing law imposes sanctions against Iranian financial institutions, including the Central Bank of Iran ("CBI"), and authorizes the imposition of sanctions against foreign financial institutions that knowingly conduct or facilitate certain significant financial transactions with the CBI. The National Defense Authorization Act of 2012 ("NDAA") exempted financial institutions owned or controlled by foreign governments from these sanctions, except to the extent that these financial institutions engaged in petroleum-related transactions with Iranian financial institutions. ITRSHRA reduces the scope of this exemption by providing that all foreign financial institutions, including government-owned financial institutions, are subject to sanctions for conducting or facilitating non-petroleum related transactions with Iran. Thus, both petroleum and non-petroleum related transactions by foreign financial institutions with Iranian financial institutions are now sanctionable.

ITRSHRA also heightens the standards for the President to grant waivers from the Iran sanctions regime. It requires, for example, that any waivers be granted on a case-by-case basis and only continue for a maximum period of one year, after which they expire unless the President renews them. Under the previous regime, waivers could be granted on a blanket basis or for an indefinite duration and were not required to be revisited. Also, the substantive standards for waivers are now heightened – the President must make findings that a waiver is "essential" or "vital" to U.S. interests, rather than merely "necessary," as under the prior law.

Expansion of Sanctioned Activities

ITRSHRA authorizes the imposition of sanctions on persons and entities, located worldwide, that engage in a broad variety of transactions with Iran, including financial activities. The specific sanctions that may be applied are detailed, and the types of conduct that may be subject to sanction are numerous. For example:

Purchases of Government of Iran Debt. ITRSHRA expands the types of sanctionable financial activities to include purchasing, subscribing to or facilitating the issuance of sovereign debt of the Government of Iran or the debt of any entity owned or controlled by the Government of Iran.

Financial Messaging Services. ITRSHRA imposes sanctions on financial messaging services, which heretofore had not been sanctioned under U.S. law. An example of an entity that provides financial messaging services is SWIFT, a financial messaging network that facilitates efficient functioning of the worldwide payment system. Beginning November 8, 2012, the President may impose sanctions on persons who knowingly and directly provide financial messaging services to, or knowingly enable or facilitate direct or indirect access to such messaging services for, the CBI or designated financial institutions that have been sanctioned for activities relating to terrorism and proliferation of WMDs.

Sanctions may not be imposed on persons providing financial messaging services who (i) are already subject to a substantially similar sanctions regime under governing foreign law, and (ii) have, pursuant to that sanctions regime, terminated the knowing provision of messaging services to the sanctioned financial institutions. This exception appears intended to account for the European Union's imposition of comprehensive sanctions against persons that provide financial messaging services to the Iranian financial system.

Insurance or Reinsurance Relating to the National Iranian Oil Company or the National Iranian Tanker Company. ITRSHRA authorizes sanctions against persons that knowingly provide underwriting services or insurance or reinsurance for the National Iranian

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Oil Company, the National Iranian Tanker Company, any company owned or controlled by either of those companies, or any successor entity to either of those companies. The President may choose not to impose these sanctions if the President determines that the person exercised due diligence and established and enforced policies, procedures and controls to prevent violations.

Activities Relating to the Proliferation of WMDs and Advanced Conventional Weapons. ITRSHRA expands the scope of sanctionable activities relating to the development of WMDs and advanced conventional weapons by Iran. ITRSHRA provides that exporting, transferring, or permitting or otherwise facilitating the transshipment of any goods, services, technology, or other items to any other person that contribute to Iran's development of WMDs or advanced conventional weapons is a sanctionable activity.

Joint Ventures Relating to the Mining, Production or Transportation of Uranium. Knowing participation in a joint venture involving any activity relating to the mining, production or transportation of uranium and that benefits an Iranian entity is a sanctionable activity.

Petroleum and Petrochemicals. ITRSHRA also contains numerous provisions that expand existing sanctions against the provision of various types of support and assistance to Iran's production of petroleum and petrochemicals. For example, the provision of goods, services, or technology may be subject to sanctions if they directly and significantly contribute to Iran's ability to (i) develop domestic petroleum production or refining capacity, or (ii) expand domestic production of petrochemical products. Similarly, the ITRSHR Act authorizes sanctions against persons who are controlling beneficial owners of, or who otherwise own, operate, control, or insure, vessels used to transport crude oil from Iran. The President may also sanction persons who use vessels to conceal the Iranian origin of crude oil; in such cases, the concealing vessel may be barred from U.S. ports for two years. Joint ventures with the Government of Iran to exploit petroleum resources outside of Iran are also sanctionable, unless they predate 2002.

Revolutionary Guards. ITRSHRA also requires the President to take numerous actions against Iran's Revolutionary Guard. Among other things, the President must identify, designate as an SDN and sanction any foreign person that (i) is an official, agent or affiliate of Iran's Islamic Revolutionary Guard Corps; (ii) knowingly assists, sponsors or supports the Revolutionary Guards or any of its officials, agents, or affiliates designated as SDNs for their affiliation with the Revolutionary Guards; or (iii) engages in significant transactions with the Revolutionary Guards or any of its officials, agents, or affiliates that are designated as SDNs for their affiliation with the Revolutionary Guards

Sanctions Against Human Rights Abuses

Finally, ITRSHRA codifies and expands the President's existing authority under Executive Order 13066 to sanction individuals that provide Iran or Syria with goods or services likely to be used to abuse human rights. Among other things, the new law requires the President to identify and sanction persons determined to have knowingly transferred or facilitated the transfer of goods or technologies – including firearms, ammunition, and surveillance technology -- likely to be used by the Government of Iran to commit serious human rights abuses against its people; or provided services (including hardware, software, specialized information, consulting, engineering and support services) with respect to such goods or technologies.

* * *

ITRSHRA represents the third law enacted in the United States over the past two years, each imposing progressively more restrictive sanctions against Iran. This new law is exceptionally detailed, but, in principal part, continues the trend of seeking to isolate Iran from international markets and focusing on Iran's petroleum industries and Iran's ability to develop WMDs.

ITRSHRA makes it more difficult for U.S. and foreign companies to engage in business with Iran because those activities are more likely to become sanctionable conduct under U.S. law. ITRSHRA will, more than likely, increase compliance burdens and risks for U.S. and foreign companies, which will need to take practical measures to ensure that they do not transgress the newly imposed restrictions.

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Federal Reserve Proposes Systemic Risk Report for Large Financial Institutions

By Gregory J. Lyons, Paul D. Patton, Samuel E. Proctor

On August 20, 2012, the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") published in the Federal Register a proposal (the "FR Y-15 Proposal") for certain large financial institutions ("Covered Companies") to submit a new Banking Organization Systemic Risk Report (the "FR Y-15") to the Federal Reserve Board on an annual basis.[1] This report is based on prior efforts by the Financial Stability Board and the Basel Committee on Banking Supervision (the "Basel Committee") to develop an assessment methodology for identifying global systemically important banks ("G-SIBs"). However, the Covered Companies required to file the FR Y-15 extends far beyond the U.S. financial institutions that were designated as G-SIBs last year and, as proposed, will include all bank holding companies ("BHCs") and savings and loan holding companies ("SLHCs") with $50 billion or more in total consolidated assets, as well as foreign banking organizations ('FBOs") with $50 billion or more of total assets in their combined U.S. operations, including branches. The Federal Reserve Board has proposed that the filing deadline for FR Y-15 Reports will be 45 calendar days after each year-end, and that all of the information contained in such reports be made publicly available through the Federal Financial Institutions Examination Counsel ("FFIEC") website. Although the comment period for the FR Y-15 Proposal closes on October 19, 2012, the first FR Y-15 reports would be due to the Federal Reserve Board next Valentine's Day, February 14, 2013, which leaves little time for Covered Companies to develop systems to provide appropriate and comprehensive reporting. This Article (i) provides additional background on the FR Y-15 Proposal; (iii) describes the specific information that Covered Companies must supply; and (iii) describes a number of the more salient implications of this new regulatory reporting regime that is fast approaching those within its ambit.

Background

In response to the recent financial crisis, the Financial Stability Board, in October 2010, requested that the Basel Committee develop an assessment methodology to assess the systemic risk of global systemically important financial institutions; i.e., financial institutions "whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity."[2] In response, the Basel Committee proposed and finalized an assessment methodology for identifying G-SIBs (the "G-SIB Methodology"). The G-SIB Methodology is indicator-based, and focuses on the following five components of a banking organizations potential systemic risk footprint: (i) size; (ii) interconnectedness; (iii) substitutability; (iv) complexity; and (v) cross-jurisdictional activity. Applying the methodology,[3] the Financial Stability Board, in November 2011, designated an initial set of 29 G-SIBs.[4]

The Federal Reserve states that the FR Y-15 will collect data derived "directly" from the G-SIB Methodology, and is consistent with an international agreement reached by the Basel Committee to assess the systemic importance of banking organizations with total on- and off-balance sheet exposures in excess of 100 billion euros. As part of this effort, the Federal Reserve Board would submit data collected from submissions of the FR Y-15 to the Basel Committee for purposes of determining whether a BHC is a G-SIB, and if so, what additional capital requirement would be applied to that G-SIB. In addition, the full data set (i) would be used

1 Proposed Agency Information Collection Activities; Comment Request 77 Fed. Reg. 50,102 (Aug. 20, 2012).

2 Press Release, Financial Stability Board, Policy Measures to Address Systemically Important Financial Institutions (Nov. 4, 2011), *available at* www.financialstabilityboard.org/ publications/ r_111104bb.pdf.

3 Basel Committee, *global systemically important banks: assessment methodology and the additional loss absorbency requirement* (Nov. 2011), *available at* www.bis.org/publ/bcbs207.pdf.

4 Financial Stability Board Press Release, *supra* note 2.

Federal Reserve Proposes Systemic Risk Report

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by the Federal Reserve Board to assess the systemic risk implications of proposed mergers and acquisitions, and (ii) may be used by the Federal Reserve to determine whether an institution is a domestic systemically important bank.

A Covered Company's consolidated, top-tier holding company will be considered the reporting entity for purposes of the FRY-15. All offices (including branches and subsidiaries) within the scope of the consolidated holding company will need to be reported on a consolidated basis. Covered Companies will be required to prepare and submit the FR Y-15 in accordance with generally accepted accounting principles ("GAAP") and its instructions. The FR Y-15 will be required to be signed by the Covered Company's Chief Financial Officer, or by an individual performing an equivalent function. By signing, the person will be acknowledging that a knowing and willful misrepresentation of a material fact in the FR Y-15 constitutes fraud subject to legal sanction. The Federal Reserve Board proposes to implement the collection of the FR Y-15 as of December 31, 2012, so that it could be used for purposes of the Basel Committee G-SIB data collection exercise that is scheduled to begin in February 2013. According to the Federal Reserve Board, approximately 25 domestic BHCs, 15 SLHCs and 23 FBOs would file the FR Y-15.

Required Information Covered Companies will be required to provide information on the following six schedules on the FR Y-15:

- Schedule A – Size Indicators;
- Schedule B – Interconnectedness Indicators;
- Schedule C – Substitutability / Financial Institution Infrastructure Indicators;
- Schedule D – Complexity Indicators;
- Schedule E – Cross-Jurisdictional Activity Indicators; and
- Schedule F – Ancillary Indicators.

Covered Companies will be required to provide a variety of balance sheet data on each of the above schedules. For example, Covered Companies will be required to report total on-balance sheet and certain off-balance sheet items, as well as data on securities financing and derivatives transactions on Schedule A for size indicators.

The FR Y-15 Proposal differs from the G-SIB Methodology in three key respects. First, the FR Y-15 Proposal explicitly requires Covered Companies to provide data on so-called "ancillary" indicators in Schedule F. By contrast, ancillary indicators are not explicitly included in the G-SIB Methodology, and instead were contemplated as optional indicators that could be used in addition to the five-indicator framework. Second, the FR Y-15 Proposal will require Covered Companies to provide information on the FR Y-15 that is not required under the G-SIB Methodology. For example, while the G-SIB Methodology's "complexity" indicator uses data on only a banking organization's Level 3 assets as an input, the FR Y-15 Proposal will require Covered Companies to provide data on holdings of Level 1, Level 2, *and* Level 3 assets. Third, while the G-SIB Methodology weights each of the individual five indicators equally as 20 percent of a banking organization's G-SIB "score" (*e.g.*, size indicator weighted at 20 percent, interconnectedness indicator weighted at 20 percent, etc.), the FR Y-15 Proposal does not indicate what, if any, weight the Federal Reserve Board will assign to each individual schedule.

> The FR Y-15 Proposal represents an initial effort by the Federal Reserve Board to align its domestic data collection efforts with international efforts relating to the identification (and potential regulation) of systemically important banking organizations.

Implications

Covered Companies should be aware of the following issues presented by the FR Y-15 Proposal:

Submission Deadline and Implementation Burden. The FR Y-15 Proposal contemplates an initial filing of the FR Y-15 using data as of December 31, 2012, with

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a filing deadline of 45 calendar days after this date. This deadline gives rise to a relatively constrained timeline that may present issues for Covered Companies that will need to collect and aggregate the substantial data necessary to complete the FR Y-15 in advance of the deadline. Depending on the state of a Covered Company's management information systems ("MIS systems") infrastructure, this data collection and aggregation process may present challenges. Although the Federal Reserve Board estimates that Covered Companies will incur 180 burden hours to complete the FR Y-15, the actual implementation burden is likely to be substantially more extensive than that estimated by the Federal Reserve Board.

Impact on SLHCs Predominantly Engaged in Insurance Activities. The FR Y-15 Proposal may present particular challenges for SLHCs that are predominantly engaged in insurance activities (including insurance-centric SLHCs that are organized in mutual form). Many of these companies' existing MIS infrastructures have been built to report financial information under Statutory Accounting Principles ("SAP"), an accounting system developed for insurance companies, rather than GAAP. Given the significant differences between SAP and GAAP, insurance-centric SLHCs may face additional administrative and compliance burdens when collecting the data necessary to complete the FR Y-15. The Federal Reserve Board has recognized that insurance-centric SLHCs face particular challenges in adopting to Federal Reserve Board regulation and supervision and associated GAAP reporting, and has granted insurance-centric SLHCs temporary exemptions from certain disclosure and reporting requirements.[5] It remains to be seen whether the Federal Reserve Board will ultimately grant SLHCs a similar transition period with respect to the FR Y-15.

Domestic Systemically Important Banks. The Federal Reserve Board indicates that the data gathered from the FR Y-15 may be used to "determine whether an institution is a domestic systemically important bank." This statement appears to be a reference to an August 2012 Basel Committee consultative document that addressed the extension of the G-SIB Methodology to banking organizations that are systemically important at a domestic, but not an international, level ("D-SIBs").[6] If the Federal Reserve Board is in fact indicating that the FR Y-15 will be used to assess whether Covered Companies should be designated as D-SIBs in the U.S., the FR Y-15 Proposal may have significant implications for Covered Companies, not least because designation as a D-SIB could result in the Federak Reserve imposing an additional capital surcharge on a designated institution.

5 *See, e.g.,* Agency Information Collection Activities Regarding Savings and Loan Holding Companies: Announcement of Board Approval Under Delegated Authority and Submission to OMB, 76 Fed. Reg. 81,933 (Feb. 29, 2012) (Exempting certain SLHCs from certain Federal Reserve reporting requirements).

6 BCBS, *A framework for dealing with domestic systemically important banks* (June 2012), *available at* www.bis.org/publ/bcbs224.pdf.

FBOs. The FR Y-15 Proposal is noteworthy, in that it represents an initial attempt by the Federal Reserve Board to require enhanced reporting from FBOs with a significant U.S. presence. With the passage of Dodd-Frank, the Federal Reserve Board has imposed several enhanced disclosure and reporting requirements on U.S. banking organizations with $50 billion or more in total consolidated assets, the most noteworthy being the introduction of the FR Y-14 series of reports.[7] Prior to the issuance of the FR Y-15 Proposal, however, the Federal Reserve Board had refrained from imposing enhanced disclosure and reporting requirements on FBOs of comparable size.

Conclusion

The FR Y-15 Proposal represents an initial effort by the Federal Reserve Board to align its domestic data collection efforts with international efforts relating to the identification (and potential regulation) of systemically important banking organizations. In theory, the Federal Reserve Board's efforts to align international and domestic data collection requirements for large financial institutions should come as no surprise. However, the imposition of the requirement to file the FR Y-15 is somewhat surprising in its application to (i) FBOs, in that the Federal Reserve Board has heretofore refrained from

7 *See, e.g.,* Proposed Agency Information Collection Activities; Comment Request, 77 Fed. Reg. 10,525 (Feb. 22, 2012) (Proposing revisions to the FR Y-14 series).

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imposing additional disclosure and reporting requirements on FBOs since enactment of Dodd-Frank and (ii) SLHCs, in that several of the Covered Companies that are SLHCs are predominantly engaged in insurance activities, and therefore do not appear to fit the profile of a global or domestic systemically important "bank," despite the fact these institutions are Covered Companies by virtue of their affiliate with a savings association.

As a matter of implementation, the FR Y-15 Proposal appears to provide Covered Companies with an extremely limited timeframe to undertake the necessary steps to prepare and submit the FR Y-15. The ability of a particular Covered Company to submit the FR Y-15 in the allotted timeframe will, of course, depend on a variety of factors, including that particular Covered Company's existing MIS and data collection infrastructure. However, as discussed, existing MIS capabilities appear to vary among Covered Companies, meaning that compliance may be substantially more difficult for some categories of Covered Companies than for others.

Finally, it is important to note that the FR Y-15 Proposal potentially represents an effort by the Federal Reserve Board to the lay a foundation for the eventual imposition of a "systemically important" capital surcharge on some subset of Covered Companies that are domiciled in the United States. For example, in recent notices of proposed rulemaking implementing the Basel III capital framework in the U.S., the Federal Reserve Board indicated its intent to "propose a quantitative risk-based capital surcharge in the United States based on the Basel Committee approach and consistent with the Basel Committee's implementation time frame."[8] This statement is consistent with statements in the FR Y-15 Proposal that the FR Y-15 may be used to determine whether one or more Covered Companies is a D-SIB. Given these statements, it appears that the Federal Reserve Board may use the data collected through the FR Y-15 to (i) impose a capital surcharge based on the G-SIB Methodology on the largest Covered Companies; and (ii) separately impose a capital surcharge based on the D-SIB Methodology on other Covered Companies whose systemic significance does not rise to the level of a G-SIB. Of course, the imposition of such a capital surcharge would represent a significant development for affected institutions.

8 Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792, 52,799 (Aug. 30, 2012).

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focus on its property and casualty, group benefits and mutual funds businesses. Since this announcement, The Hartford has entered agreements to sell its individual annuity new business capabilities to Forethought Financial Group, its broker-dealer, Woodbury Financial Services, to AIG, its retirement plans business to MassMutual and its individual life business to Prudential Financial.

> Insurance companies are reevaluating their presence overseas as views of global diversification change.

Repayment of government aid has also driven recent M&A activity in Europe. The Dutch financial institution, ING, received Dutch government aid in 2008 and, in its repayment plan, agreed to sell its insurance business by 2013. ING sold its Latin American insurance operations to Grupo de Inversiones Suramericana in 2011, is reported to be considering an I.P.O. of its U.S. life insurance operations, and is in the process of selling its Asian life insurance businesses (as mentioned above, AIA recently agreed to acquire ING's Malaysia operations). AEGON, another Dutch company, also received government assistance and repaid this aid in part through the sale of its U.S. reinsurance unit, Transamerica Reinsurance, to SCOR in 2011.

The Royal Bank of Scotland, which received assistance from the British government, has also been repaying the money it received. As part of the terms for receiving aid, The Royal Bank of Scotland is required to divest its insurance business and has offered shares of its Direct Line Insurance Group in an initial public offering in October of this year.

Evolving Views of Global Diversification

Insurance companies are reevaluating their presence overseas as views of global diversification change. Taiwan, once considered a desirable market, is now saturated and foreign insurers have been selling businesses on the island. New York Life, AIG, MetLife and MassMutual have all sold their Taiwan interests, and Aviva Plc announced in July 2012 that it would look to exit the Taiwan market as well.

In contrast with Taiwan, insurers are moving into Latin America and Russia. New York Life's focus on its life insurance and investments businesses opened the door for ACE Group to diversify its Mexico business by purchasing a surety bond business, Fianzas Monterrey. Similarly, HSBC's plan to sell non-core businesses has provided opportunities for acquirers in Latin America. QBE Insurance Group Limited, an Australian company, acquired HSBC's general insurance business in Argentina, and AXA Group acquired HSBC's general insurance portfolio in Mexico. QBE and AXA also each entered into 10 year bancassurance agreements with HSBC. The agreements provide that AXA will be the exclusive provider of property and casualty products to HSBC customers in Mexico and QBE will be the exclusive provider of general insurance products to customers of HSBC Group in Argentina. Other recent acquisitions in Latin America include U.K.-based RSA Insurance Group PLC's purchase of two Argentine insurance companies, Aseguradora de Creditos y Garantias and El Comercio Compania de Seguros.

As noted above, Russia is another growing market in which insurance groups are looking to expand. For example, Liberty Mutual entered Russia's property and casualty insurance market in March of this year with its acquisition of 99.99% of KIT Finance Insurance, the Russian insurance company.

Another change to the global landscape is Japanese insurance companies now looking beyond Japan's borders for growth opportunities, a trend that had not been seen for some time. Recent examples include Tokio Marine Holdings Inc. acquiring two U.S.-based companies (Delphi Financial Group Inc. in May 2012, and Philadelphia Consolidated Holding Corp. in December 2008), and Nippon Life Insurance acquiring a 26% stake in the Indian life insurer Reliance Life Insurance, a deal which was announced in March 2011. In addition, Mitsui Sumitomo purchased New York Life's joint venture stake in Max New York Life, an Indian life insurance company.

Bermuda

Bermuda is another region generating M&A activity. Although traditional strategic deals, where an insurance company acquires another insurance company, are still getting done, in recent years alternative asset managers have also become active in the market, both through acquisitions and by starting their own reinsurance companies.

Recent examples of the traditional deals include the acquisition by U.S.-

based CNA Financial Corporation of Hardy Underwriting Bermuda Limited, U.K.-based Canopius Group Ltd.'s acquisition of Omega Insurance Holdings Ltd., Bermuda-based Validus Holdings Ltd.'s acquisition of Flagstone Reinsurance Holdings and Goldman Sachs Group's purchase of Ariel Reinsurance's Bermuda-based insurance and reinsurance operations. The Goldman/Ariel Re transaction added significant scale to Goldman's property and casualty reinsurance business, which it has operated since 2005.

Bermuda-based Athene Holding Ltd., backed by private equity firm Apollo Global Management, is an example of the second trend. In July 2012, Athene Annuity & Life Assurance Co. (a subsidiary of Athene Holding), agreed to acquire Presidential Life Corp. Presidential sells fixed annuity, life, accident and health insurance products. Athene has purchased other annuity businesses, including Investors Insurance Corp. from SCOR in 2011, and serves as a good example of asset management firms looking to increase their assets under management by purchasing spread-based annuity businesses.

The third trend in Bermuda is hedge funds forming their own reinsurance companies. Hedge fund-backed Greenlight Capital Re was formed in the Cayman Islands in 2004 and paved the way for the recent start-ups in Bermuda. In the past year, three hedge funds started Bermuda reinsurers: Third Point LLC started Third Point Reinsurance, Paulson & Co. started PaCRe Ltd., and SAC Capital Advisors LP started SAC Re Ltd. These start-ups all share a focus on low-volatility reinsurance lines and an emphasis on innovative asset management.

The Bermuda market still has numerous mid-size players, which may lead to further consolidation.

Looking Ahead

Looking forward, the current regulatory and economic climate will have an impact on M&A activity and the landscape of the global insurance industry. In particular, Solvency II may be a large driver for future M&A activity for European insurers, as new capital and risk management requirements lead companies to exit certain lines of business. However, there is uncertainty about the timing of the new rules, as the European Parliament has pushed back its vote to March 2013. If the Solvency II start date is also postponed, it may well forestall some M&A activity, causing companies to hold off from entering into transactions as they wait for the final legislation. And, as always in the insurance industry, M&A activity could be spurred by catastrophes, whether they are man-made – as in the European debt crisis – or not.

The emergence of asset managers as a source of buy-side M&A activity, the need to address changing capital requirements, the desire to deploy capital in high-growth markets, and the steady increase in bancassurance activity all have given rise to a busy 2012 in the insurance M&A market, and we expect the activity to extend into 2013.

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