CLIENT UPDATE

IAIS PROPOSES MEASURES FOR ENHANCED G-SII SUPERVISION

NEW YORK
Ethan T. James
etjames@debevoise.com

WASHINGTON, D.C.
Satish M. Kini
smkini@debevoise.com

Amanda Greenwold Wise
agwise@debevoise.com

On October 17, 2012 the International Association of Insurance Supervisors published "Global Systemically Important Insurers: Proposed Policy Measures."[1] The IAIS proposal describes the special supervisory regime to be applied to any insurers designated by the IAIS as a G-SII. As proposed, these measures could alter the U.S. regulatory regime, could require some G-SIIs to exit or segregate certain lines of business, and could impose higher solvency standards than those of the G-SII's home regulator. The measures would also require G-SIIs to prepare advanced recovery and resolution proposals. Comments on this proposal are due December 16, 2012.

BACKGROUND

In response to the recent global economic crisis, the G-20 and the Financial Stability Board initiated a global effort to identify global systemically important financial institutions, and to mitigate the risks these institutions pose to the global economy. Acting on a request from the FSB, in November 2011 the Basel Committee finalized a framework for identifying global systemically important banks, and requiring additional loss absorbency in those institutions. At the same time, the FSB announced its first list of G-SIBs, which it revised on November 1, 2012.

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1 The proposed measures can be found at http://www.iaisweb.org/view/element_href.cfm?src=1/16647.pdf

The FSB assigned IAIS the task of identifying global systemically important insurers, and suggesting how to mitigate the risks G-SIIs pose to the global economy. In May of this year, the IAIS proposed an assessment methodology "to identify any insurers whose distress or disorderly failure, because of their size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity." On September 21, 2012, the IAIS published its proposed resolution of the issues raised by comments on the assessment methodology.

As part of its plan to identify G-SIIs, IAIS sent two separate data requests to a selected group of insurers worldwide, including, we believe, fourteen in the United States. Some time between now and early 2013, FIO and the appropriate state regulators may reach out to companies the IAIS has identified as potential G-SIIs for information in addition to the data call submissions. The IAIS intends to designate its first G-SIIs by April 2013.

The IAIS does not have the power to implement these measures on its own. Each G-SII's home jurisdiction would need to adopt and enforce the measures to give them the force of law.

PROPOSED POLICY MEASURES

The G-SII measures are based on the premise that the traditional insurance business model is not inherently systemically important. Systemic risk attributable to insurers, according to the IAIS, arises in two ways. The first the IAIS calls "non-traditional and non-insurance," or NTNI, activities. Although IAIS in its proposed G-SII assessment measures provided some insight into what might be NTNI activities, it has not taken a conclusive and comprehensive position on the issue and the proposed measures do not add new insight.

The second identified source of systemic risk is interconnectedness. As with the NTNI activities, this proposal does not elaborate on the interconnectedness indicia already published in the proposed assessment methodology.

The proposed measures address these risks in three ways. First, the measures call for strong consolidated group-wide supervision, with supervisory powers over not just the insurance activities of a diversified financial institution, but also over other lines of business and, importantly, including the ability to prohibit, curtail, or separate activities that contribute to a G-SII's systemic importance. Second, the insurer must plan in advance for recovery or reorganization. Third, the IAIS proposes requiring a "higher loss absorption capacity" potentially in excess of the solvency reserves required by the G-SII's home jurisdiction.

- Consolidated Group-wide Supervision: The IAIS recognizes that implementation of these measures will require "strong cooperation" among authorities. While application of the Insurance Core Principles and the measures ultimately agreed to in ComFrame will serve as the foundation for this cooperation, the IAIS measures call for each G-SII to have a supervisor with direct authority over group entities, including parents and affiliates.

  Implementation of consolidated group-wide supervision might involve fundamental structural changes to U.S. regulation. Generally, insurance is regulated by the states, while the federal government supervises certain bank, savings-and-loan, brokerage, and other financial activities. For non-bank institutions designated as domestic SIFIs by the FSOC, the Federal Reserve Board will have some consolidated supervisory functions. For other institutions, it could result in one state insurance regulator ceding primary supervisory authorities to another state regulator, or, potentially, to a federal or foreign regulator. The United States would have to revise its existing regulations and institutions to create a single consolidated group supervisor for G-SIIs, which could have deep implications for the U.S. regulatory regime. It could also, at least in the short term, create great regulatory uncertainty.

  The proposed IAIS measures would allow the group-wide supervisor to require a G-SII to separate, reduce, or eliminate its NTNI activities from its traditional insurance business. The result could be a regulatory override of business decisions, as well a restriction on insurers' ability to innovate and diversify. It could result in market disruptions, and reduce consumers' access to a wide variety of financial products and services.

- Effective Resolution: IAIS also proposes requiring G-SIIs to plan for their own financial distress or resolution. Much like Dodd-Frank's requirement that national SIFIs prepare "living wills" these policy measures mandate that a G-SII have a recovery and resolution plan, as well as a pre-identified crisis management group. The IAIS measures take the further step of calling for adoption of institution-specific cross-border cooperation agreements. The measures suggest that IAIS may issue a template for assessing resolvability of G-SIIs.

- Higher Loss Absorption: The measures will require "higher loss absorption," which could be at the group level, at the entity level, or both. HLA is a solvency standard, which the IAIS could apply in addition to existing local solvency regimes. HLA levels will be based on solvency control levels memorialized in the IAIS "insurance core principles" as well as those under discussion in the ComFrame process. This release is not sufficiently detailed to determine how the HLA standard would compare to existing U.S. state solvency regimes. In addition, a company engaged in what the IAIS describes as "banking or bank-like activities" may be subject to an HLA standard based on Basel III rules.

CONCLUSION

The IAIS proposed measures add additional uncertainty for companies operating in multiple jurisdictions as debate continues about the best response to the problem of systemic risk. Even with the delay in the implementation of Solvency II, it appears increasingly likely that authorities will reach some type of international agreement on supervision and cooperation. It remains to be seen how the United States' regulatory apparatus - through the state regulators, FIO, and the FSOC, among others – will respond to these proposed measures and other international regulatory projects.

Interested parties, whether individually or as a group, may submit comments to the IAIS via the Consultations page on its website, http://iaisweb.org . All comments will be published on the IAIS website, unless a specific request is made for comments to remain confidential.

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Please do not hesitate to contact us with any questions.

November 7, 2012