

Client Update

IAIS Consults on G-SIIs and NTNI: Are G-SIIs Sellers of Non-Core and NTNI Business Units?

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INTRODUCTION

On November 25, 2015, the International Association of Insurance Supervisors (“IAIS”) began two public consultations: the first on proposed updates to the assessment methodology for Global Systemically Important Insurers (“G-SIIs”) and the second on an analytical framework for Non-Traditional Non-Insurance (“NTNI”) activities and products.

IAIS rules require G-SIIs to hold additional capital to support NTNI activities, which is explicitly intended to create an incentive for the effective separation of systemically important NTNI activities from traditional insurance business, as part of G-SIIs’ group-wide supervision and systemic risk management. As a result, G-SIIs may look to divest NTNI and non-core businesses in order to reduce capital requirements and, potentially, have their G-SII designation revoked.

Ongoing reviews by G-SIIs of their business strategies and NTNI and non-core business units could drive downstream strategic M&A opportunities for all participants in the insurance sector, and non-G-SII firms and other financial investors may be particularly well-positioned to be buyers of these assets.

G-SIIS

G-SIIs are classified as insurers whose distress or disorderly failure, because of size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity. A list of current G-SIIs can be found in our previous Update following the changes on November 3, 2015.

The IAIS published its initial assessment methodology for G-SIIs in July 2013, with plans to evaluate every three years whether the methodology ought to be reviewed and revised. The consultation is a result of the first three-year review and outlines proposed revisions to the initial methodology.

The proposed changes to the assessment methodology include:

- a five-phase approach to the assessment process that includes both quantitative and qualitative elements;
- changes to certain indicators to address issues related to indicator responsiveness, normalization and data quality, including reliability;
- adoption of absolute reference values for certain indicators such as the financial guarantees, derivatives trading and reinsurance indicators; and
- establishment of specific procedures for an insurer's entry and exit from the G-SII list.

The five phases of the assessment process under the proposed methodology are: (i) data collection; (ii) quality control and scoring, then determination of the quantitative threshold; (iii) discovery; (iv) exchange with prospective G-SIIs; and (v) IAIS recommendation to the Financial Stability Board ("FSB"). Phases (i) and (ii) incorporate the quantitative component, then phases (iii) and (iv) comprise both quantitative and qualitative elements, and finally, phase (v) brings all the elements together into an overall assessment leading to the IAIS recommendation to the FSB.

NTNI

NTNI activities and products play an important role in the assessment methodology as well as the determination of the Basic Capital Requirement and Higher Loss Absorbency Requirement applicable to G-SIIs. NTNI activity attracts higher capital requirements than traditional insurance business.

The consultation proposes an analytical framework for classifying insurance products and activities as "non-traditional" based on their contractual features, focusing particularly on features that expose an insurer to substantial market or liquidity risk. Substantial market risk would be assessed by analysing whether the product includes a guaranteed benefit, and whether the insurer has the ability to invest in assets that match the cashflows required to pay the benefit. Liquidity risk would be assessed by looking at the economic penalty on withdrawals and surrenders, and the time delay a policyholder would face in withdrawing funds.

The proposed framework is the first step of a three-step process to clarify the NTNI concept and help ensure its consistent application across IAIS projects and IAIS member jurisdictions. The three steps of the process will be: (i) finalise the analytical framework; (ii) assess and clarify a list of products and activities; and (iii) identify any gaps in, or necessary modifications to, the framework and existing principles.

WHAT NEXT?

A public background call will be held on December 15, 2015 in order to describe the consultations and the specific issues for which the IAIS is seeking input. Comments are then due on both consultations by January 25, 2016 and the IAIS intends to apply the new methodology and incorporate the new analytical framework into the G-SII designation exercise in 2016.

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Please do not hesitate to contact us with any questions.