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Briefing note

July 2013

Global Systemically Important Insurers – who are they and what will it mean to be a GSII?

The International Association of Insurance Supervisors (**IAIS**) has released its assessment methodology and policy measures for global systemically important insurers (**GSIIs**) as well as an overall framework for macroprudential policy and surveillance.

GSIIs are a class of global systemically important financial institutions (SIFIs) with the latter being defined by the Financial Stability Board (FSB) as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause dislocation in the global financial system and adverse economic consequences across a range of countries". On 18 July 2013, the IAIS released its assessment methodology and policy measures for GSIIs as well as an overall framework for macroprudential policy and surveillance. In this briefing we summarise the methodology and measures as well as the proposed timeline.

The FSB, in consultation with the IAIS and national authorities, has also released an initial list of 9 GSIIs, namely Allianz SE, American International Group, Inc., Assicurazioni Generali S.p.A., Aviva plc, Axa S.A., MetLife, Inc., Ping An Insurance (Group) Company of China, Ltd., Prudential Financial, Inc. and Prudential plc. These GSIIs have been identified using the assessment methodology produced by the IAIS.

After 2013, GSIIs will be designated on an annual basis each November in order to align the designation timetable with that of banking industry SIFIs. As part of this annual review process, existing GSIIs may be removed from the list should they no longer satisfy the relevant assessment criteria.

Insurance Europe, representing insurance associations in the EU, has criticised a system which leads to the identification of individual insurers rather than specific activities that might pose systemic risk. The Chair of the Global Federation of Insurance Associations has expressed disappointment that the starting point for both the measures and methodology to assess systematic risk in insurance was the work done to address systemic risk in the banking industry when the nature of the assets and liabilities of insurers is very different from that of banks.

Assessment Methodology

The assessment methodology describes the IAIS methodology for identifying and assessing the systemically important insurers.

The initial assessment is indicator-based. Additional quantitative assessment takes the form of a business segment specific risk-weighted assessment approach known as the "IFS assessment approach".

The indicator-based approach is consistent with that adopted by the Basel Committee on Banking Supervision in assessing global systemically important banks, although the selection, grouping and weighting of indicators reflect the specifics of the insurance sector. The indicators are grouped into five categories:

- Size: indicators include total assets and total revenues
- Global activity: indicators include revenues derived outside of

home country and number of countries of operation

- Interconnectedness: indicators include intra-financial assets and liabilities, reinsurance, derivatives, turnover, large exposures and level 3 assets (assets the fair value of which cannot be determined by using observable measures)
- non-traditional or non-insurance (**NTNI**) activities: indicators include derivatives trading, non-policyholder and non-insurance revenues from financial activities, financial guarantees, short-term funding, intra-group commitments, extent of liquidity of insurance liabilities
- Substitutability: indicators include premiums for specific business lines

IAIS consider that the two most important categories for assessing the systemic importance of insurers are the NTNI activities and interconnectedness categories which attract higher weightings of 45% and 40% respectively. The weighting for each of the remaining categories is 5%.

The weightings are broken down further within each category with a percentage allocation being given to each indicator. This approach was used to provide a first assessment of the relative systematic importance of insurers, with additional candidates selected from the results of the quantitative IFS assessment approach.

The IFS assessment approach centres around segmenting the business portfolio of insurance companies and insurance-dominated groups in traditional and non-traditional activities as well as non-insurance financial and non-insurance industrial activities. The assessment approach then associates risk weights commensurate with the systemic importance of the various business activities of insurance companies.

Policy Measures

Consistent with the FSB's framework of policies for SIFIS, the policy measures for GSIIs focus on three main elements:

- enhanced supervision;
- effective resolution; and
- higher loss absorption (**HLA**) capacity.

It is currently unclear how these will interact with other regulatory changes such as more risk based supervision generally and the implementation of Solvency II with its increased quality of capital requirements. However, significant divergence between the IAIS regulatory regime and the EU solvency regimes is not expected as the European Commission has commented that great care has been taken to ensure that the proposed Solvency II regime remains in line with IAIS international guidelines, as well as ongoing IAIS efforts to develop a truly global regulatory and supervisory framework for the insurance industry. Arguably, the UK Prudential Regulation Authority through its approach to supervision is already adopting an enhanced approach to supervising SIFIs.

The IAIS has set out a detailed timetable for implementation of the policy measures for GSIIs, including policy measures on HLA, running until January 2019. Whilst it is not clear at this stage how implementation will work, it may be that actual implementation is left to national supervisors and, in some cases, supra-national authorities (e.g. in Europe, the European Insurance and Occupational Pensions Authority). The implementation of policy measures for GSIIs will be monitored by an IAIS peer review process in order to ensure international consistency.

The group-wide supervisor for each identified GSII is expected to contact the GSII to begin the policy measures implementation process.

Enhanced Supervision

The foundation for the IAIS's approach on enhanced supervision is the existing IAIS Insurance Core Principles (**ICPs**). The key elements of enhanced supervision can be found in the Policy Measures and are as follows:

- Direct approach to consolidated and group-wide supervision, including direct supervision of holding companies.
- Each GSII is required to produce and implement a Systemic Risk Management Plan (**SRMP**) to describe how it will manage, mitigate and possibly reduce its systemic risk and which will be overseen by the group-wide supervisor. The SRMP will be in addition to the Recovery and Resolution Plans (**RRPs**).
- If appropriate, SRMPs may separate systemically important NTNI activities from traditional insurance business. Where this is contemplated, the separated entities must be structurally and

financially self-sufficient, e.g. no parental guarantees or multiple-gearing.

Effective Resolution

GSIIs should comply with the international standard for resolution published in 2011 by the FSB for SIFIs (Key Attributes) as the IAIS concurs that the requirements are also relevant to GSIIs. The requirements include:

- the establishment of a crisis management group (**CMG**)
- the elaboration of RRPs
- carrying out resolvability assessments
- adoption of institution-specific intra-group, cross-border co-operation agreements involving all members of a firm's cross-border CMG, including the relevant authorities from the home and all key host jurisdictions

However, in planning for effective resolution, GSIIs should account for insurance specificities which include (a) plans and steps needed for the separation of NTNI activities (b) the possible use of portfolio transfers and (c) run-off arrangements and the existence of policyholder protection and guarantee schemes.

In order to carry out an effective resolution, the IAIS states that authorities will need to have a broad range of tools at their disposal to allow them to intervene quickly to avoid destabilisation and to protect policyholders.

Higher Loss Absorption

The IAIS is developing backstop capital requirements to apply to all group activities (including non-insurance subsidiaries). These requirements will be finalised by the end of 2014 and will form the foundation for HLA requirements for GSIIs. The approach to the HLA requirements again reflect the IAIS view that an insurer's NTNI activities are the source of potential systemic risk and accordingly, the rationale for the HLA requirements is that those GSIIs who conduct NTNI activities should have a HLA capacity as this well help reduce its probability of failure. HLA capacity requirements should be met by permanent capital that is always fully available to cover losses.

The IAIS proposes that the calculation of HLA capacity will depend upon whether the NTNI activities have been effectively separated from traditional insurance business. For example, where there has been effective separation, where possible, HLA may be calculated based on the NTNI activities and applied to those separate entities conducting them. The HLA uplift is likely to be greater if the NTNI activities have not been separated.

The IAIS has provided a general categorisation of products into traditional and non-traditional and has also set out a number of principles to guide in this classification. The IAIS considers that NTNI activities "involve financial features such as leverage, liquidity or maturity transformation, imperfect transfer of credit risks, (i.e. “shadow banking”), credit guarantees or minimum financial guarantees" and also involve "products that are more financially complex than traditional insurance products in the shifting of financial market risk to insurers". Products where liabilities are significantly correlated with financial market outcomes are also identified as products of concern. The IAIS also recognises that not all products will fall neatly into their principles or examples given variable features and will, in those cases, seek to rely generally on the judgement of group-wide supervisors in order to appropriately classify such products.

After public consultation, the IAIS will develop by the end of 2015 the implementation details for HLA that will apply to designated GSIIs from 2019.

Macroprudential Policy and Surveillance (MPS)

The IAIS has also released a framework for Macroprudential Policy and Surveillance in insurance (MPS) which builds on the ICPS approved in October 2011. The main objective of MPS is to take a market-wide perspective and to limit or mitigate systemic risks with the goal of maintaining financial stability and minimising the incidence and impact of disruptions in the provision of key financial products and services that can have adverse consequences for the real economy and broader implications for economic growth.

Internationally Active Insurance Groups

Although the policy measures discussed above will only apply to those insurers designated as GSII, all insurers and insurance groups will need to comply with the ICPs.

In addition, over and above the ICPs, Internationally Active Insurance Groups ("**IAIGs**") will also need to comply with the IAIS Common Framework (**ComFrame**) for the Supervision of IAIGs which is currently being developed and will build on the ICPs in respect of cross-border supervision of IAIGs through the global convergence of regulatory and supervisory measures. The project will identify those insurance groups considered to be IAIGs and designation will not hinge on whether or not a group is regarded as systemically important. ComFrame is not expected to establish GSII specific measures as the measures are expected to supplement the supervisory measures.

Reinsurers

The GSII designation of reinsurers has been deferred to July 2014 to provide additional time for the systemic risks posed by the business models of major reinsurers to be evaluated and for the appropriate policy measures to be identified in order to mitigate the risks associated with reinsurers. The IAIS is of the view that issues relating to suitability and interconnectedness are more complex in the case of reinsurers than insurers and are also focused on the systemic risk posed by the non-insurance activities conducted by reinsurers (e.g. writing credit default swaps).

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Key Implementation Dates

July 2013	Designation of GSIIs based on IAIS methodology (annual updates published by FSB each November beginning in 2014). For GSIIs, commencement of resolution planning and resolvability assessment requirements of the FSB Key Attributes of Effective Resolution Regimes and enhanced supervision, including group-wide supervision.	**End 2015**	IAIS to develop implementation details for HLA that will apply starting from 2019 to those GSIIs identified in November 2017 using IAIS methodology.
End 2013	FSB to agree on the timeline for finalisation by IAIS of a comprehensive, group-wide supervisory and regulatory framework for IAIGs, including a quantitative capital standard.	**July 2016**	Implementation for SRMPs to be assessed.
July 2014	CMGs established for the initial GSIIs. FSB to make a decision on the GSII status of, and appropriate risk mitigating measures for, major reinsurers. SRMPs to be completed by GSIIs designated in 2013.	**November 2017**	FSB to designate cohort of GSIIs (based on IAIS methodology and 2016 data) for which HLA measures will apply.
By 2014 G20 Summit	IAIS to develop backstop capital requirements to apply to all group activities, including non-insurance subsidiaries.	**January 2019**	GSIIs designated in November 2017 to apply the HLA requirements.
End 2014	RRPs, including liquidity risk management plans, for GSIIs designated in 2013 to be developed and agreed by CMGs.		