International Association of Insurance Supervisors

Global Systemically Important Insurers: Policy Measures

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About the IAIS

The International Association of Insurance Supervisors (IAIS) is a voluntary membership organization of insurance supervisors and regulators from more than 200 jurisdictions in nearly 140 countries. The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability.

Established in 1994, the IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets. In addition to active participation of its Members, the IAIS benefits from input in select IAIS activities from Observers representing international institutions, professional associations and insurance and reinsurance companies, as well as consultants and other professionals.

The IAIS coordinates its work with other international financial policymakers and associations of supervisors or regulators, and assists in shaping financial systems globally. In particular, the IAIS is a member of the Financial Stability Board (FSB), founding member and co-parent of the Joint Forum, along with the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO), member of the Standards Advisory Council of the International Accounting Standards Board (IASB), and partner in the Access to Insurance Initiative (A2ii). In recognition of its collective expertise, the IAIS also is routinely called upon by the G20 leaders and other international standard setting bodies for input on insurance issues as well as on issues related to the regulation and supervision of the global financial sector.

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Cover note

The global financial crisis underscored the interconnected nature of financial firms and the widespread financial and economic costs of their severe distress or failure as well as with public sector interventions for those that were distressed or expected to fail. The crisis also underscored the need for public authorities to act promptly and proactively to identify financial firms that are systemically important and to take measures to lessen the impact and reduce the moral hazard associated with public sector interventions and the distress or failure of such financial firms.

As part of this effort, the International Association of Insurance Supervisors (IAIS) is participating in a global initiative, along with other standard setters, central banks and financial sector supervisors, and under the purview of the Financial Stability Board (FSB) and G20, to identify global systemically important financial institutions (G-SIFIs[1]). The focus of the IAIS' analysis is in relation to potential Global Systemically Important Insurers (G-SIIs).

The IAIS has developed an assessment methodology for insurance-dominated conglomerates, insurance groups and 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. The IAIS has now also completed the framework of policy measures that should be applied to insurers that are determined to be G-SIIs.

Interested parties may wish to consult relevant background papers which are available on the IAIS, FSB and Basel Committee on Banking Supervision (BCBS) websites, including the IAIS' report *Insurance and Financial Stability (IFS).*[2] Other key papers include:

- the IMF/FSB/BIS (Bank for International Settlements (BIS) staff report submitted to the G20 Finance Ministers and Central Bank Governors entitled *Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments*[3] (October 2009);
- the FSB's recommendations on *Reducing the moral hazard posed by systemically important financial institutions (SIFIs)* [4] (October 2010);
- the BCBS framework for identifying global systemically important banks (G-SIBs) and requirements for additional loss absorbency for G-SIBs[5] (November 2011); and
- the determination of the first cohort of G-SIBs [6] (November 2011).

[1] G-SIFIs are defined by the FSB as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries." G-SIIs are one class of G-SIFIs.

[2] See IAIS (2011) http://www.iaisweb.org/Other-papers-and-reports-46

[3] See http://www.imf.org/external/np/g20/pdf/100109.pdf

[4] See http://www.financialstabilityboard.org/publications/r_101111a.pdf

[5] See http://www.bis.org/publ/bcbs207.pdf

[6] See Policy Measures to Address Systemically Important Financial Institutions, November 2011, See http://www.financialstabilityboard.org/publications/r_111104bb.pdf

Glossary of abbreviations

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CDS	Credit Default Swap
ComFrame	IAIS Common Framework for the Supervision of Internationally Active Insurance Groups
CMGs	Crisis Management Groups
FSB	Financial Stability Board
G-SIBs	Global Systemically Important Banks
G-SIFIs	Global Systemically Important Financial Institutions
G-SIIs	Global Systemically Important Insurers
G20	Group of Twenty Countries
GWS	Group-wide Supervisor
HLA	Higher Loss Absorbency or Higher Loss Absorption capacity
IAIGs	Internationally Active Insurance Groups
IAIS	International Association of Insurance Supervisors
ICPs	IAIS Insurance Core Principles
IFS	IAIS report *Insurance and Financial Stability*
IGT	Intra-group Transactions
Key Attributes	FSB's *Key Attributes for Effective Resolution Regimes*
LA	Loss Absorbency
MCR	Minimum Capital Requirement
NTNI	Non-traditional insurance and Non-insurance
PCR	Prescribed Capital Requirement
RRPs	Recovery and Resolution Plans
SIE	FSB's Supervisory Intensity and Effectiveness recommendations
SIFIs	Systemically Important Financial Institutions
SRMP	Systemic Risk Management Plan

Contents

Executive Summary

Financial Stability Board (FSB) framework for G-SIFIs

The FSB framework for reducing the moral hazard and risk to the global financial system posed by systemically important financial institutions (SIFIs)[7] recommends several policies which should combine to:

- Apply more intensive and co-ordinated supervision of SIFIs,
- Improve the authorities' ability to resolve SIFIs in an orderly manner without destabilising the financial system or increasing taxpayers' exposure to loss.
- Require higher loss absorption (HLA) capacity for SIFIs to reflect the greater risks that these institutions pose to the global financial system, and
- Apply other supplementary prudential and other regulatory requirements as determined in conjunction with the national authorities.

Policy measures

The International Association of Insurance Supervisors (IAIS) has developed a framework of policy measures for global systemically important insurers (G-SIIs) in line with the FSB recommendations; however, the proposed HLA measures will be subject to further consultation before they are finalised in 2015 in advance of the proposed implementation date of 2019. Measures will often require strong cooperation among authorities, including authorities with responsibility for non-insurance entities. Reference in this document to actions by group-wide supervisors (GWS) should be interpreted as including consultation with other involved supervisors, possibly via the setup of a supervisory college where regarded as appropriate within the group-supervision framework.

The framework of policy measures includes:

1) Enhanced supervision

The foundation for G-SII policy measures is the existing IAIS Insurance Core Principles[8] (ICPs). The FSB's Supervisory Intensity and Effectiveness recommendations (SIE recommendations)[9] form the basis of the IAIS' approach to enhanced supervision. In addition, the IAIS Common Framework for the Supervision of Internationally Active Insurance

[7] Global SIFIs (G-SIFIs) are defined by the FSB as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries." Global systemically important insurers (G-SIIs) are one class of G-SIFIs.

[8] Refer to http://www.iaisweb.org/view/element_href.cfm?src=1/13037.pdf or to http://www.iaisweb.org/ICP-on-line-tool-689

[9] See http://www.financialstabilityboard.org/publications/r_121031ab.pdf, http://www.financialstabilityboard.org/publications/r_111104ee.pdf, and http://www.financialstabilityboard.org/publications/r_101101.pdf

Groups (ComFrame)[10] will aim to foster global convergence of regulatory and supervisory measures and approaches for Internationally Active Insurance Groups (IAIGs), whether or not they are identified as G-SIIs. ComFrame is not expected to establish specific policy measures that focus on addressing systemic risk for G-SIIs as such, but rather may provide a baseline for applying supplemental supervisory measures to address the systemic risks of a G-SII that is also an IAIG. To that end, the key elements of enhanced supervision for G-SIIs are summarised below.

- The group-wide supervisor should have direct powers over holding companies to ensure that a direct approach to consolidated and group-wide supervision can be applied. Special attention should be paid to group-wide supervision since G-SIIs are most likely to take the form of a group and NTNI (non-traditional and non-insurance) activities are often carried out by separate entities within a group and/or the group may have significant interconnections to other parts of the financial system. The supervisor should require G-SIIs to have, in particular, adequate arrangements in place to deal with liquidity risk management for the whole group, primarily for the NTNI business, but also for the remainder of the G-SII.

- The group-wide supervisor should oversee the development and implementation of a Systemic Risk Management Plan (SRMP) by each G-SII (in addition to a recovery and resolution plans (RRPs)). The purpose of the SRMP is for the G-SII, under the oversight of the group-wide supervisor, to describe how it will manage, mitigate and possibly reduce its systemic risk. It is anticipated that the SRMP will be made available to the IAIS in order to evaluate and improve its assessment methodology going forward. Where feasible and appropriate, the SRMP may include effective separation of systemically important NTNI activities from traditional insurance business and/or restrictions or prohibitions of specified systemically important activities or any other measures.

- Where separation of NTNI activities is contemplated, it is necessary to ensure the self-sufficiency of the separated entities in terms of structure and financial condition. Structural aspects of self-sufficiency will likely involve a combination of restructuring measures and the restriction or prohibition of parental guarantees and cross-default clauses to ensure that any separation into legal entities is not undermined by contractual obligations. Self-sufficiency in terms of financial condition means there should be no capital or funding subsidies, multiple-gearing or double leverage. Any necessary interconnectedness that remains between the separated entity and other parts of the G-SII should be addressed by the application of other consequential measures (e.g. restrictions or HLA).

- It is the role of the group-wide supervisor to prevent the process of effectively separating NTNI activities from resulting in the creation of non-regulated financial entities. Financial entities created in the separation process of separating NTNI activities should be under oversight of the direct supervisory authority and the group-wide supervisor (although these could be one and the same). Consideration should be given to any direct or indirect measures imposed by functional supervisors.

[10] ComFrame is the IAIS project to develop a Common Framework for the Supervision of Internationally Active Insurance Groups by 2013, in order to foster group-wide supervision and global convergence of regulatory and supervisory approaches. See http://www.iaisweb.org/Common-Framework--765

2) Effective resolution

In 2011, the FSB published an international standard for resolution – *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes).[11] The authorities who supervise G-SIIs and G-SIIs themselves should comply with the Key Attributes. This standard sets out a range of specific requirements that should apply to any financial institution that could be systemically significant or critical if it were to fail. The requirements that apply to G-SIFIs include the: (i) establishment of Crisis Management Groups (CMGs); (ii) elaboration of recovery and resolution plans (RRPs); (iii) carrying out of resolvability assessments; and (iv) adoption of institution-specific, cross-border cooperation agreements.

For G-SIIs, effective resolution will take account of the specificities of insurance, including:

- Plans and completed steps needed for the separation of NTNI activities from traditional insurance activities (e.g. via effective separation of such NTNI activities),
- The possible use of portfolio transfers and run-off arrangements as part of the resolution of entities conducting traditional insurance activities, and
- The existence of policyholder protection and guarantee schemes (or similar arrangements).

3) Loss Absorption (LA) – Applicable to all group activities

As a foundation for HLA requirements for G-SIIs, the IAIS will as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the end of 2014.

4) Higher Loss Absorption (HLA) capacity – Applicable to NT and NI activities

G-SIIs should have higher loss absorption (HLA) capacity for conducting NT and NI activities. Mandating a HLA capacity for a G-SII will help to reduce its probability of failure. This is important given the greater risks that the failure of a G-SII poses to the global financial system. After public consultation, the IAIS will develop by the end of 2015 the implementation details for HLA that will apply to designated G-SIIs starting from 2019. The IAIS will also consult on related issues (including the scope of the G-SII group on which HLA will be assessed).

The IAIS proposes that a distinction should be made when applying HLA capacity. Specifically, the calculation should depend upon whether the NTNI financial activities have been effectively separated from the traditional insurance business. The IAIS also proposes that, when possible, HLA should be targeted as follows at the entities where the systemically important actives are located:

- Where the G-SII has demonstrated effective separation of NTNI activities from traditional insurance activities, targeted HLA may be calculated based on the NTNI activities and applied to the separated entities conducting them.

[11] Refer to Key Attributes for Effective Resolution Regimes for Financial Institutions, October 2011. Refer to http://www.financialstabilityboard.org/publications/r_111104cc.pdf

- Where NTNI activities are not effectively separated, HLA may be calculated based on the NTNI activities in the consolidated insurance group[12] (including the parent company) taking account of the insurance group's interconnectedness score (yielding an HLA uplift greater than if the activities had been separated).

HLA capacity requirements should be met by the highest quality capital; namely, permanent capital that is fully available to cover losses of the insurer at all times on a going-concern basis.

The HLA assessment may take into account any capital charges imposed to mitigate the systemic risk of an insurer that are in place under national legislation.

Implementation time frame

It is expected that the first cohort of G-SIIs will be designated and subsequently published in July 2013. G-SII measures on enhanced supervision (including development of the SRMP) and effective resolution should begin to be implemented immediately afterwards. RRPs, including liquidity risk management plans, should be developed and agreed by CMGs by the end of 2014. The SRMP should be completed within 12 months after designation for the first group of G-SIIs. After that, the implementation should be completed in time for the next year's assessment. The implementation of the SRMP should be assessed by the group-wide supervisor in 2016. Measures on HLA capacity should begin to be implemented in 2019 for the G-SIIs designated in 2017.

A sound capital and supervisory framework for the insurance sector more broadly is essential for supporting financial stability. Accordingly, the IAIS will prepare by October 2013 a workplan to develop a comprehensive, group-wide supervisory and regulatory framework for IAIGs, including a quantitative capital standard.

The IAIS expects national authorities to prepare a framework in which insurers will be able to provide high quality data for the indicators in the G-SII assessment methodology. To ensure the transparency of the methodology (for the benefit of market participants and to promote market discipline) and the efficient identification of G-SIIs, the data used should ideally be made public. The IAIS will work with participating authorities to enable such publication over the coming years.

Implementation of G-SII policy measures should also be monitored by an IAIS peer review process in order to ensure international consistency. The full implementation timeframe is:

[12] The term "insurance group" is used throughout this document to mean the entire consolidated firm or enterprise (including the parent company). It does not mean, or refer to, only the group of licensed insurance entities.

Key Implementation Dates and Timeframes	Action required (or intermediate activity)
July 2013	The FSB to designate the initial cohort of G-SIIs based on the IAIS methodology using 2011 data (with annual updates thereafter published by the FSB each November, beginning in 2014) For designated G-SIIs, implementation commences of resolution planning and resolvability assessment requirements of the FSB Key Attributes of Effective Resolution Regimes and enhanced supervision, including group-wide supervision
October 2013	IAIS to prepare a workplan to develop a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard
July 2014	Crisis Management Groups (CMGs) established for the initial cohort of designated G-SIIs IAIS to provide the FSB with a recommendation on the G-SII status of, and appropriate risk mitigating measures for, major reinsurers
July 2014	Systemic Risk Management Plan (SRMP) to be completed
September 2014	IAIS to finalise straightforward, backstop capital requirements (loss absorbency – LA) to apply to all group activities, including non-insurance subsidiaries
End 2014	Recovery and resolution plans, including liquidity risk management plans, for the initial cohort of designated G-SIIs to be developed and agreed by CMGs
End 2015	IAIS to develop implementation details for HLA that will apply to designated G-SIIs starting from 2019
July 2016	Implementation of SRMPs to be assessed
November 2017	The FSB to designate the cohort of G-SIIs, based on the IAIS methodology and 2016 data, for which the HLA policy measure will apply, with implementation beginning in 2019
January 2019	G-SIIs designated in November 2017 to apply the HLA requirements

1. Introduction

(1) The IAIS is participating in a global initiative, along with other standard setters, central banks and financial sector supervisors, and under the purview of the FSB and G20, to identify G-SIFIs[13]. The focus of IAIS analysis is in relation to potential G-SIIs. To this end, the IAIS has developed an initial assessment methodology *Global Systemically Important Insurers (G-SIIs): Initial Assessment Methodology* explaining the initial assessment methodology to identify any insurers whose distress or disorderly failure would cause significant disruption to the global financial system and economic activity. Any such insurers will be regarded as systemically important on a global basis.

(2) The IAIS has now also developed a framework of policy measures for G-SIIs. It is based upon the general framework published by the FSB [14] with suitable adjustments designed to apply to the distinctive features of insurance dominated financial conglomerates. As with the initial assessment methodology, these adjustments reflect the factors that make insurers, and the reasons why they might be systemically important, different to other financial institutions.

(3) At the Summit meeting in Seoul, November 2010, the G20 leaders endorsed the FSB's framework for reducing the moral hazard posed by systemically important financial institutions. The framework recommends several policies which should combine to:

- Apply more intensive and co-ordinated supervision of SIFIs,
- Improve the authorities' ability to resolve SIFIs in an orderly manner without destabilising the financial system and exposing the taxpayer to the risk of loss,
- Require higher loss absorbency for SIFIs to reflect the greater risks that these institutions pose to the global financial system,
- Strengthen core financial infrastructures, and
- Provide other supplementary prudential and other requirements as determined by the national authorities.

(4) As discussed in the IAIS' report *Insurance and Financial Stability*[15] the two most important factors for assessing the systemic importance of insurers are NTNI activities and the degree of interconnectedness. NTNI activities are important because, among other matters, the longer timeframe over which insurance liabilities can normally be managed may not be present. Interconnectedness is important because there can be strong connections between the insurance sector, banking sector and financial markets that can amplify the impact of stress events.

[13] G-SIFIs are defined by the FSB as "institutions of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries." Global systemically important insurers (G-SIIs) are one class of G-SIFIs.

[14] Refer to FSB reports "Reducing the moral hazard posed by systemically important financial institutions" (2010) http://www.financialstabilityboard.org/publications/r_101111a.pdf and "Policy Measures to Address Systemically Important Financial Institutions" (2011) http://www.financialstabilityboard.org/publications/r_111104bb.pdf

[15] Refer to http://www.iaisweb.org/Other-papers-and-reports-46

Therefore, the policy measures specifically address these causes of systemic importance.

2. Overview

2.1 The supervisory challenges in relation to G-SIIs

(5) G-SIIs are a risk to financial stability because their scope, the nature of their business and their position in the financial system is such that their distress or failure might, cause disruption to the wider financial system and the real economy.

(6) G-SIIs are different from Global Systemically Important Banks (G-SIBs), in part because the traditional insurance business model is not inherently systemically important. The designation of banks tends to be driven by the sheer size and nature of their core activities, while size alone is less important for traditional insurers. Insurers vary widely from banks in their structures and activities and consequently in the nature and degree of risks they pose to the global financial system. The activities that might make an insurer a G-SII can vary greatly from one insurer to another, but are generally related to their NTNI activities and any interconnectedness generated from those activities. This requires a policy response designed to address the specific nature and source of systemic importance and the different drivers of possible negative externalities.

2.2 Objectives of G-SII policy measures

(7) G-SII policy measures should reduce moral hazard and internalize the costs of the negative externalities stemming from the potential disorderly failure posed by a G-SII. These policy measures should:

- Reduce the probability and impact of distress or failure of G-SIIs and thus reduce the expected systemic impacts which disorderly failure may cause,
- Incentivise G-SIIs to become less systemically important, and give non-G-SIIs strong disincentives from becoming G-SIIs, and
- Be linked to the drivers of the G-SII status of each individual insurer.

(8) G-SIIs may be regarded as a safe haven by policyholders and institutional investors, either because of a perceived implicit state guarantee or because the policy measures are understood to bring an additional level of security. Within the financial market place, this might have substantial distortional consequences. For example, the G-SII designation of insurers could result in giving G-SIIs access to lower funding costs. The financial strength rating assessments by credit rating agencies and the proprietary bespoke ratings assigned by banks, investment banks, repo dealers and other counterparties today do not assume any implicit state guarantee for insurers. Conversely, the additional supervisory layer imposed by a G-SII regulatory regime could bring about additional costs through higher capital requirements that consumers may be willing to bear in exchange for greater safety. During implementation of the policy measures for G-SIIs, unintended consequences should be considered and avoided where possible.

3. The G-SII policy measures

3.1 Overview

(9) The IAIS framework of policy measures for G-SIIs is in line with the FSB recommendations and includes the following components:

- **Enhanced supervision**: Enhanced supervision applies immediately to all G-SIIs to ensure that they rapidly achieve the higher standards of risk management their G-SII status demands. The ICPs, ComFrame, and the FSB's SIE recommendations provide the foundation for the IAIS' approach to enhanced supervision, while special emphasis is placed on group-wide supervision and liquidity planning as described below. The group-wide supervisors should also analyse activities that cause systemic importance of G-SIIs and take necessary measures to reduce that systemic importance. This includes overseeing the development and implementation of a SRMP which could include measures such as separation of NTNI activities from traditional insurance business and/or restriction or prohibition of systemically important NTNI activities.
- **Increased resolvability**: The FSB's Key Attributes provide the basis for improved resolvability and would help reduce the impact of a G-SII failing. Under the Key Attributes, all G-SIIs will be required to produce RRPs in cooperation with their group-wide supervisor. The relevant authorities will also be required to establish a CMG, conduct resolvability assessments and have cooperation agreements with other involved supervisors.
- **Loss Absorbency (LA) capacity:** G-SIIs will be required to hold regulatory capital for all group activities. The development of backstop capital requirements will be completed by the end of 2014 and the requirements will apply shortly thereafter.
- **Higher loss absorption (HLA) capacity**: In addition, G-SIIs will be subject to an increased loss absorption capacity requirement based on the NTNI activities that those G-SIIs undertake. The calculation and location of the additional capital requirement may depend upon whether the G-SII has demonstrated effective separation of NTNI activities from traditional insurance activities. It is noted that some national supervisory frameworks are expected to provide for capital surcharges that account for the systemic risk profile of an insurance group and these additional capital requirements may be taken into consideration in assessing whether the G-SII has an appropriate level of HLA capacity. The proposed HLA measures will be subject to further consultation before they are finalised in 2015 in advance of the proposed implementation date of January 2019.

3.2 Definition of Traditional Insurance, Non-Traditional Insurance and financial Non-insurance (NTNI) activities

(10) The application of the above mentioned measures may rely to a large extent upon the clear differentiation between traditional and NTNI activities.

(11) The classification of activities as traditional, non-traditional and non-insurance relies on the following considerations. First, the NTNI principles set forth below should guide the determination of whether activities are classified as traditional or

non-traditional/ non-insurance. Second, Table 1 (below) is provided to further help in this effort by delineating the classifications of specific exemplary products and business activities. Third, as insurance products may vary significantly in their specific features (and across jurisdictions), the application of the guiding principles to products that deviate from the exemplary products described in this paper are left to the judgement of the group-wide supervisor, subject to a peer review for the purpose of IAIS' objectives for the harmonisation of insurance standards.

(12) This document further develops the work begun in the IAIS report *Insurance and Financial Stability (IFS)*[16] by expanding on the guiding principles for the allocation of products to the traditional or non-traditional categories. This approach is based on the predominance of risk characteristics used to determine whether an insurance product or financial activity is considered either traditional (T) or non-traditional (NT). Therefore, products classified as semi traditional in the IFS paper have mainly been allocated to the non-traditional classification.[17] As stated above, these products tend to vary significantly in their specific features (and across jurisdictions), and group-wide supervisors will need to consider the extent of systemic risk posed by specific products.

3.2.1 Traditional insurance activities

(13) The IFS report defines traditional insurance business primarily by building on the concept of the insurability of risks, in particular the insured events' accidental nature, random occurrence and the applicability of the law of large numbers.[18] The law of large numbers helps an insurer to manage and price risks in an efficient manner. The ex-ante payment of insurance premiums and the time to the occurrence of claims, known as an inverted product cycle, usually further benefit the liquidity and investment management of an insurance company. In these instances, asset and liability management (ALM) activities aim to closely match the nature of liabilities and assets.

3.2.2 Non-traditional, non-insurance activities

General description

(14) Non-traditional and non-insurance 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. They also often involve products that are more financially complex than traditional insurance products in the shifting of financial market risk to insurers. Other products of concern include those where the liabilities are significantly correlated with financial market outcomes, such as stock prices, and the economic business cycle.

(15) Financial activities conducted outside of a licensed insurance entity are categorised as non-insurance.

[16] Insurance and Financial Stability, IAIS.

[17] The IAIS scoring methodology will need to reflect in its future data analysis and designation work this approach and its categorisation of insurance activities as traditional and NTNI.

[18] Insurance and Financial Stability, IAIS, p. 13

NTNI Principles

(16)	Principle 1: Products that provide credit guarantees to financial products such as securities, mortgages and other traded or non-traded instruments - whether principal or interest - can be considered NTNI.

Explanation: Even though the idiosyncratic parts of the credit risk may be readily diversifiable, insurers providing such coverage are nonetheless vulnerable to systematic[19] risk and therefore vulnerable to shocks that affect the entire economy or that otherwise tighten correlations. The guaranteed debt is often dispersed throughout the economy, and the impairment of the value of the guarantee of the debt instrument due to the distress or failure of the insurer could result in a severe impact on the economy. When credit guarantee or coverage is short-term in nature then the exposure to systematic events is limited. Such products could be considered traditional.

(17)	Principle 2: Policies or products that expose the insurer to substantial market and liquidity risk and require a more complex risk management practice by the insurer in order to hedge those risks and may require substantial, complex, and dynamic use of derivatives, can be considered NTNI.

Explanation: The complexity of the risk management necessary to handle such risky products exposes insurers to sizeable market and liquidity risk, increases the potential for modelling errors, makes them more reliant on over-the-counter derivatives markets and increases their interconnectivity through the greater volume of transactions. This creates the potential for fire sales or procyclical hedging strategies. The decision to hedge complex risks, while desirable from a microprudential perspective, in turn increases the interconnectedness of the respective insurer, thus making it more dependent on functioning derivatives markets.

Examples:

a) Products that give the customer or policyholder the right to choose to invest premiums in different markets (e.g. the equities market), at the commencement of or throughout the contract, in conjunction with a guaranteed minimum performance of the account, essentially creates a put option for the policyholder. This requires complex modelling and forecasting of policyholders' behaviour and management of complex financial market risks. In contrast, a minimum guarantee on general account performance does not place the insurer in as difficult a situation.

b) Products that give the policyholder a considerable long-term performance promise and a tangible short-term liquidity promise, which cannot be matched simultaneously by a portfolio of existing cash market securities.

[19] As distinct from 'systemic'.

(18) Principle 3: Investment and funding or other capital market activities that result in maturity or liquidity transformation, leverage or imperfect transfer of credit risk, such as repo and securities lending, beyond that justified by the scope and scale of conducting traditional insurance activities, can be considered NTNI.

Explanation: The categories of traditional, non-traditional and non-insurance also apply to investment activities, whether on balance sheet or off. The degree to which investment activities involve the points of concern mentioned in this principle and the extent to which they support traditional insurance business will determine their classification as NTNI.

This principle addresses concerns identified by the FSB's analysis of shadow banking. It aims to capture those activities that can increase leverage, increase risks from proprietary speculation, reduce transparency from investments in private pools of capital, and make the insurer more reliant on the trading and funding liquidity of capital markets.

Examples:

a) If the cash collateral from the repurchase agreement or securities lending transaction is reinvested in liquid, high credit quality assets, and if the security lent or put out on a repo is liquid, then the activity is traditional. However if the reinvestment is in long-term, or low credit quality or illiquid securities then the risks are sufficient for the activities to be deemed NTNI. Moreover if low credit quality or illiquid assets are used for securities lending or in repurchase agreements, then the risks are sufficient to be deemed NTNI.

b) If in the course of supporting normal investment management a short credit default swap (sold credit protection) is combined with a government security in order to synthetically replicate an investment in a conventional fixed income security, which might be a better investment due to better pricing or liquidity, then it is traditional. Similar investing in foreign currency corporate bonds and using a foreign currency swap to convert the interest and principal of these securities into the local currency in which insurance liabilities are denominated would be traditional. Essentially, if synthetic replication creates similar risks as investing in the conventional security, then it is traditional. If it adds leverage or reduces liquidity, then it is NTNI. If comparable credit default swaps are bought and sold in order to profit from changes in credit spreads or the term structure of credit spreads, then it is a non-traditional or non-insurance activity. The group-wide supervisor should be careful to discern other investment strategies involving the combination of derivatives and securities that might appear similar but whose motivation is speculation, arbitrage or other opportunistic views on the market.

(19) The systemic risk of some variable annuities products (marked with a star in Table 1 below) is associated with the nature and scope of the guarantees and not the product more generally. Where partial guarantees are provided that are comparable to the guarantees of traditional products, it may be necessary for the group-wide supervisor to consult with involved supervisors and classify the products as traditional, if appropriate.

(20) Classification of some typical insurance activities and products (illustrative and still under active discussion) is shown below:

Table 1. Classification of typical insurance activities

Traditional	**Non-Traditional**
Non-Life (P&C plus Heath, Disability)	Annuity: Variable Annuity - GMIB (Fixed accumulation returns) (*)
Non-Life: Long-tail (they involve some interest rate risk, but are still predominantly non-financial)	Guaranteed minimum death benefit (GMDB) or Guaranteed minimum annuitisation rate (*)
Life - Term - Fixed Death Benefits, Fixed Premium	Guaranteed Minimum Withdrawal Benefit (GMWB) (*)
Life - Term - Variable Benefit, Variable Premium (investment return risk borne by policyholder)	Contingent Deferred Annuity (some longevity risk, mostly market return risk) (*)
Life - Whole life with fixed death benefits (implicit fixed accumulation rate)	Unit-linked accounts with guaranteed account value or non-negative returns (some longevity risk, mostly a financial guarantee) (*)
Life - Whole Life with variable account value (includes risk of investment returns)	Guaranteed Investment Contracts (GICs)
Life - Whole Life with some minimum accumulation rate or minimum death benefit	Synthetic GIC (insurer bears market value/return risk
Annuity with Fixed Rate of Return	Mortgage Insurance (credit guarantee)
Annuity with Variable rate of return (insurer bears longevity risk, policy holder the investment returns)	Credit Guarantees - municipal debt, structured credit products, (pure credit guarantee)
Variable Accumulation, Fixed Payout	
Insurance-linked securities (ILS), e.g. Cat Bonds and other forms.	Financing or monetizing ILS, e.g. Embedded Value/Present Value of Future Profit securitisations, ILS with financial risk as material trigger condition.
Short-term trade credit insurance	

3.3 Enhanced supervision

3.3.1 General description

(21) Enhanced supervision applies immediately to all designated G-SIIs. In line with the SIE recommendations, enhanced supervision of G-SIIs will generally mean tailored regulation, greater supervisory resources and bolder use of existing supervisory tools compared to the supervision of non-systemically important insurers. The enhanced supervision of G-SIIs should rest on a direct approach to group-wide supervision. Enhanced supervision should include coordination with involved supervisors,[20] and should especially focus on the unique risk profile and possible risk concentrations of G-SIIs in order to lessen the probability and impact of distress or failure. In so doing, involved supervisors should take into account the reasons for the systemic importance of the G-SII suggested by the results of the G-SII assessment methodology.

(22) The desired outcomes of enhanced supervision are:

- The group-wide supervisor determines a set of measures to reduce the risks posed by the G-SII and establishes timelines and indicators to adequately monitor the implementation and effectiveness of the measures.
- A group-wide supervisory framework applies to the insurance group as a whole – with a particular focus on its systemic risks – that features cooperation among involved supervisors, including involved supervisors with responsibility for the group's non-insurance entities. Obstacles that could hinder effective group-wide supervision are identified and removed. For G-SIIs, the group-wide supervisor has direct powers over holding companies to ensure that a direct approach to group-wide supervision can be applied.[21] In addition, other involved supervisors may have direct or indirect powers over holding companies in their jurisdiction. Consideration should be given to any direct or indirect measures/regulation by functional supervisors.
- Enhanced supervisory co-ordination is achieved via supervisory colleges (cross-sector and cross-jurisdictions).
- The group-wide supervisor has clear visibility of internal control systems and risk management and solvency assessment procedures within the insurance group. This includes requiring the G-SII to have the ability to aggregate and identify risk exposures and concentrations quickly and accurately at the group-wide level, across business lines and legal entities. It is expected that the SRMP will provide much of this information along with the type of assessment noted in the next bullet.
- The G-SII has internal controls and limits that are effective, investment and reinsurance arrangements that are appropriately diversified, greater disclosure and additional stress testing.

[20] Involved supervisors refer to home, host and foreign functional supervisors.

[21] The ICPs (in paragraph 14 of the Introduction) provide for a direct or indirect approach to group-wide supervision of insurance groups. For G-SIIs, only the direct approach is acceptable. The IAIS is in the process of amending ICP 23 to clarify some aspects of group-wide supervision.

(23) The IAIS approach to enhanced supervision builds on:

- The ICPs, which are applicable to all insurers and are the foundation for the G-SII policy measures.
- ComFrame, which will aim to foster global convergence of regulatory and supervisory measures and approaches for IAIGs, whether or not they are identified as G-SIIs. ComFrame is not expected to generate specific policy measures that focus on addressing systemic risk of G-SIIs as such, but rather may provide a baseline for applying supplemental supervisory measures to address the systemic risks of a G-SII.
- Special attention will be paid to group-wide supervision since G-SIIs are most likely to take the form of a group and NTNI activities can be carried out by separate entities within a group.
- The FSB's SIE recommendations, especially in relation to:

  – **Unambiguous mandates, independence and appropriate resources**
    Mandates geared toward active early intervention can facilitate a culture where supervisors have the will to act early. The mandate should convey the point that the group-wide supervisor's (and often the involved supervisors') view of appropriate risk tolerance for an insurance group will always reflect a higher degree of conservatism and therefore will often be a source of conflict when viewed against the respective risk appetites of senior management, the board and shareholders.

    Reinforcing the operational independence and resources of supervisory agencies is critical to ensuring supervisory effectiveness and credibility in general.

  – **Full suite of supervisory powers**
    Since the crisis, the need for tools such as increased liquidity requirements, large exposure limits, imposing dividend cuts, requiring additional capital and stress-testing have come to the forefront. Given that a full suite of such powers is critical to the ability of a supervisor to fulfil its public mission, the inventory of financial policy tools should be updated. Supervisors need to ensure that the stress testing undertaken is comprehensive and commensurate with the risks and complexities of these institutions.

  – **Improved standards and methods**
    Increased focus on outcomes of governance and business processes and greater use of horizontal reviews are desirable. Supervisors need to evaluate whether their approach to, and methods of, supervision remain effective or have, for example, moved too far toward focusing on adequacy of capital and control systems, and away from detailed assessments of sources of profits and financial data.

    Supervisory interactions with Boards and senior management should be stepped up, in terms of frequency, level of seniority, and assessment of their effectiveness. Supervisors should adopt proactive approaches to deal with succession planning and performance expectations for key positions within G-SIIs (e.g. CEOs, CROs, Internal Auditors), elements that should no longer be regarded as only internal matters for institutions.

– **Stricter assessment regime**

Group-wide supervisors should consider how their supervisory frameworks affect the internal controls (including risk management frameworks) for G-SIIs, and they should be confident that the assessment criteria for the internal control environment at G-SIIs sets a "higher bar" for these firms to achieve given the potential systemic impact that they pose. Group-wide supervisors should further explore ways to formally assess risk culture, particularly at G-SIIs. Establishing a strong risk culture at financial institutions is an essential element of good governance.

– **Group-wide supervision**

Group-wide supervision can be impaired when supervisors do not have the legal right or ability to review all the insurance group's entities (e.g. non-regulated entities, parents and other affiliates), yet those entities have the potential to pose risks to the regulated entity, the insurance group and the financial system. Supervisory blind spots can be created when there are entities within the insurance group to which the group-wide supervisor does not have access. In cases where the various functional supervisors have regulatory authority over different business lines, it is critical that these supervisors share and exchange information about their respective regulated entities and coordinate closely with other functional supervisors in order to achieve supervisory goals.

– **Risk aggregation**

Supervisors should study and adapt data needs and data processing capabilities in the context of the higher requirements for G-SII supervision. Where there are deficiencies in any or all of the type of data collected, the supervisors' ability to process the data in a timely and fulsome way or the ability to collect ad-hoc data in a timely manner, these should be addressed as soon as possible.

Supervisors need to consider putting in place additional data management and analysis processes for the information available from a range of sources, such as that collected by trade repositories and other centralised sources of financial data, so that key players in markets and market anomalies are identified. The SRMP developed by the G-SII, as described below, should incorporate the supervisory view as set forth above, and can be an important tool in assisting the supervisor in understanding how the group is reacting to potential systemic risks.

3.3.2 Systemic Risk Management Plan (SRMP)

(24) The G-SII in consultation with the group-wide supervisor should start developing the SRMP immediately after its designation. The purpose of the SRMP is for the G-SII, under the oversight of the group-wide supervisor, to describe how it will manage, mitigate and possibly reduce its systemic risk. The plan should address the risks identified in the decision to designate the insurance group as a G-SII. The SRMP is designed to coherently set out in a summary fashion all applicable measures, such as higher loss absorbency, improved resolution and enhanced supervision, that would address the ways the G-SII poses systemic risk to the financial system and the overall economy. The formulation of this plan, in consultation with the group-wide supervisor, is relevant because there may be choices to make in how to meet these regulatory goals. The G-SII could restructure, adopt restrictions or limitations on certain systemically important activities or retain the risk by internalizing the costs of negative externalities (e.g. by adding to its capacity to absorb losses).

(25) The process for developing the SRMP will require collaboration among the G-SII, the group-wide supervisor and other involved supervisors. The G-SII begins the process by presenting to the group-wide supervisor a draft that addresses the systemic issues raised in the designation process. The next step involves the group-wide supervisor responding with its views on the adequacy of the proposed measures and recommendations for improvements. After consultation with members of the supervisory college, the final version of the SRMP will provide brief but specific actions the G-SII will take in order to comply with its being designated. It is anticipated that the SRMPs will be made available to the IAIS in order to evaluate and improve its assessment methodology going forward.

(26) Where feasible and appropriate, the SRMP should describe the G-SII's enterprise risk management (ERM) system (including how it addresses liquidity risk, as described below), and how its internal controls address the systemic risks.

(27) The SRMP should include the measures that the G-SII will take to either reduce systemic risks or to mitigate those risks (e.g. through the use of additional capital so as to internalise at least some of the cost of the externalities that arise from such risk taking). These may include such measures as: effective separation (so as to achieve self-sufficiency) of systemically important activities from traditional insurance business; restrictions or prohibitions on specified systemically important activities so as to reduce the amount of such risk; HLA; or combinations of these measures and any other measures.

3.3.3 Enhanced liquidity planning and management

(28) The group-wide supervisor is responsible for evaluating and monitoring liquidity management and planning on a group-wide basis. The group-wide supervisor should require the G-SII to conduct regular gap analysis of its liquidity risks and the adequacy of its available liquidity resources, under normal and stressed conditions. It should consider stress scenarios that are forward looking and not based entirely on historical data. Adjustments for expected behaviour of market participants and customers during stressed conditions - especially in relation to acceleration of liabilities (e.g. a run on the insurer or rating triggers) - should be considered. The assessment should focus primarily on NTNI activities and the key channels of

interconnectedness. Special attention should be paid to the nature of interconnectedness, as some indicators – such as intra financial liabilities and derivatives – have a greater potential systemic impact than others. This should also include an assessment of the G-SII's Asset Liability Management and its effectiveness in addressing potential future liquidity demands. These should include written strategies and policies for regular gap analysis and liquidity risk management, subject to clearly documented governance requirements. This should include an assessment of the arrangements the G-SII has in place to manage (so as to mitigate or reduce) those risks for the whole group.

(29) Relevant issues for liquidity management and planning may include:

- The framework for managing liquidity (for example, regional or central);
- The extent of concentrated exposures, both assets and liabilities, that potentially affect the amount of short-term liquidity needs and the ability of the firm to meet them;
- A policy for managing the liability side of liquidity risk and potential effects of downgrades on rating triggers;
- The ability of securities to meet its liquidity needs even under stress conditions;
- Ways of managing both the insurance group's aggregate foreign currency liquidity needs and its needs in each individual currency;
- Access to liquidity facilities;
- The use of derivatives (including potential for collateral calls and margin calls); and
- The management of short-term sources of credit, such as from securities lending and repurchase agreement transactions.

3.3.4 Effective Separation of NTNI activities

(30) The group-wide supervisor may choose to apply effective separation of NTNI activities of G-SIIs to reduce or mitigate systemic risks.

(31) The degree of effective separation or interconnectedness within a global insurance group is important to its systemic relevance. The IFS report argues that one of the key lessons from the financial crisis is that the systemic importance of an insurance group is correlated with the amount of its NTNI activities. The systemic importance of the insurance group is also a function of how intertwined the NTNI activities are with the traditional activities of the insurance group.[22] Effective separation can therefore reduce systemic importance by helping to prevent the spill-over of detrimental effects caused by distress from NTNI activities being transmitted to the parts of the group that conduct traditional insurance business. At the same time, if supervisors allow, some insurance groups will choose not to separate for their own, sound risk management reasons that they deem to be more important than the capital benefit of separation. In either case, the G-SII will coordinate with the group-wide supervisor through the development of a SRMP (see section 3.2.2 above) that will lay out the reasons for whichever approach is chosen.

[22] Insurance and Financial Stability, page 15.

(32) Effective separation is an ex-ante policy measure intended to reduce the expected systemic impact of a G-SII by enhancing its resilience and improving its ability to be resolved without inflicting stress on the financial system. In combination with restrictions and adequate HLA, effective separation can potentially lower the expected impact of the distress or failure of the separated NTNI activities to below systemic levels.

(33) The question of what constitutes effective separation is a critical supervisory policy issue. Whether or not NTNI activities are effectively separated will directly affect its resolvability and may affect the calculation of HLA to be applied to the G-SII. The following five conditions are regulatory policy standards that are intended to serve as guidelines for the group-wide supervisor in determining whether NTNI activities are effectively separated. In applying these standards, the group-wide supervisor, after consultation with other involved supervisors, , should interpret them with sufficient flexibility as to accommodate the particular organisation of the entire enterprise, the risks it absorbs and the relevant regulatory environment. Any necessary interconnectedness that remains between the separated entity and other parts of the G-SII should be addressed by the application of other consequential measures (e.g. restrictions or HLA).

(34) A G-SII must meet the following five regulatory standards, as applied by the group-wide supervisor, in order to be deemed effectively separated. These standards, taken together, set a high but achievable standard for what is required to be deemed effectively separated by the group-wide supervisor. The breach of any one of these standards will result in a loss of status as an effectively separated G-SII.

a. An effectively separated entity (subsidiary or affiliate) must be self-sufficient to the degree that it can operate without the support of the parent or affiliates. This requires adequate stand-alone capitalization, and this must not be the result of “multiple gearing,” multiple leverage or otherwise funded by debt issued by the holding company or affiliate. The separated entity must not receive credit or capital financed with debt from the traditional entity or entities. It also entails the ability to be resolved, whether through sale, receivership or liquidation, without a drain on the resources of the parent or affiliates or on public resources.

b. The governance of the effectively separated entity or entities should provide for operational independence of management (including risk management). The term operational independence means that the management has authority over day-to-day operations even though strategic decisions may come from the parent or other ownership. The independence might be strengthened through such measures as requiring a portion of the board of directors to be independent members (independent is defined as being not part of executive management team of insurance group or its subsidiaries or members of board of parent holding company or affiliates).

c. The effective separation of NTNI activities from the insurance group’s traditional business must not result in a non-regulated financial entity. A non-regulated entity is one that does not have a solo prudential regulator or comparable prudential regulatory framework. If the group-wide supervisor has the authority to impose capital requirements or other suitable prudential requirements on an entity that otherwise lacks solo regulation, then the entity would be deemed prudentially regulated for purposes of meeting this condition.

d. Any intragroup transactions or commitments with the separated NTNI entities must be “at arm’s length.” This will help prevent subsidies from the traditional business to NTNI activities. In addition, the size or amount of these transactions or commitments should not be so large that it makes either party to such arrangements critically dependent upon the other as client, vendor or counterparty. This requirement taken together with measures in paragraph a) above will help prevent the transmission of distress from the separated entity to the traditional insurance business.

e. Reputation risk – resulting in the parent or affiliate providing financial support to an entity even though there is no legal obligation to do so - is a concern for intragroup transmission of financial stress. The group-wide supervisor should take steps necessary to minimise the likelihood and impact from this risk. The self-sufficiency condition in paragraph a) above helps to address some of this concern. If an otherwise effectively separated entity nonetheless receives support in distress circumstances then it will no longer be deemed effectively separated for the purposes of HLA assessment.

3.3.5 Restrictions and prohibitions

(35) The group-wide supervisor could choose to apply restrictions and prohibitions with the following goals in mind:

- To reduce the probability and impact of distress or failure resulting from systemically important activities within G-SIIs;
- To limit or eliminate systemically important activities based on the nature of the activity; and
- To limit or discourage such activities and thereby encourage G-SIIs to reduce or eliminate their systemically important activities and discourage other insurers from undertaking potentially systemically important activities.

(36) Restrictions and prohibitions are a direct and effective supervisory measure to reduce systemic risk. They can be applied to NTNI and interconnectedness activities and can be applied on a stand-alone basis or in combination with other policy measures. Restrictions and prohibitions can also be targeted to specific legal entities within the G-SII.

(37) Restrictions and prohibitions cover a broad range of options that include direct prohibitions, limitations and restrictions on activities as well as measures that provide strong disincentives and/or internalise the costs for engaging in systemically important activities, including:

- Direct prohibition or limitation of the systemically important activity;[23]
- Requirements for prior approval of transactions that fund or support systemically important activities;[24]
- Requirements for spreading or dispersing risks relating to systemically important activities;[25] and

[23] For example, prohibit the issue of certain financial guarantees on CDS or other financial products

[24] For example, prior approval of Intra-group Transactions (IGTs) related to NTNI activities

- Limiting or restricting diversification benefits between traditional insurance business and other businesses. This measure improves the overall capital position and hence provides HLA capacity. In practical terms, it could either be applied at ultimate parent level or at the NTNI sub-holding or entity level.[26]

(38) Given the premise that insurers are not likely to inherently generate systemic risk other than through NTNI and interconnectedness, prohibitions or strict limitations of an activity can be applied to G-SIIs where the goal is to eliminate the activity or severely curtail the relevant activity. When a systemically important activity is deemed necessary or unavoidable then, restriction may play a lesser role when compared with structural measures (e.g. segregation or separation) and HLA capacity.

3.4 Effective Resolution

(39) The desired outcomes of effective resolution are to:

- Ensure the resolution of G-SIIs can take place without severe systemic disruption and without increasing taxpayers' exposure to loss;
- Protect vital economic functions through mechanisms which make it possible for shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation;
- Ensure that policyholder protection arrangements remain as effective as possible;[27]
- Avoid unnecessary destruction of value and ensure that non-viable G-SIIs can exit the market in an orderly way; and
- Identify and remove impediments to smooth resolution.

3.4.1 Resolution regimes and tools for G-SIIs

(40) The authorities who supervise G-SIIs and G-SIIs themselves should comply with the Key Attributes,[28]an international standard for resolution published by the FSB. This standard sets out a range of specific requirements for institutions that should apply at a minimum to all G-SIFIs including G-SIIs. They include: (i) the establishment of CMGs; (ii) the elaboration of RRPs; (iii) the conduct of resolvability assessments; and (iv) the adoption of institution-specific, cross-border cooperation agreements.

(41) To carry out an effective resolution, authorities need to have at their disposal a broad range of tools that enable them to intervene safely and quickly to protect

[25] For example, limit use of affiliate reinsurance on NTNI lines of business, such as variable annuities with financial guarantees or mortgage guarantee insurance.

[26] In limiting or restricting diversification effects, G-SIIs are left with fewer options on what business segments can be recapitalised. Hence, the limitation or restriction of diversification effects shows which business segments are possibly undercapitalised and subsidised.

[27] Refer to ICP 12 "Winding-up and Exit from the Market" which states: "The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimising disruption to the timely provision of benefits to policyholders."

[28] Refer to http://www.financialstabilityboard.org/publications/r_111104cc.pdf.

policyholders and avoid destabilisation of financial markets. At present, many IAIS jurisdictions have a fourfold power in connection with the trigger points of a recovery system to require a: (i) solvency plan if the “prescribed capital requirement” (PCR) is breached; (ii) financing plan if the “minimum capital requirement” (MCR) is breached; (iii) recovery plan if the asset/liability ratio is breached; and (iv) liquidation plan if both the asset/liability ratio and the MCR are breached. These powers should be considered for RRPs of G-SIIs when they are in good health. The FSB Key Attributes should serve as a point of reference for the reform of national resolution regimes, setting out the responsibilities, instruments and powers that all national resolution regimes should have to enable authorities to resolve failing G-SIIs in an orderly manner and without exposing the taxpayer to the risk of loss.

(42) Authorities will also need to determine whether a mainly traditional insurance group with a large derivatives portfolio may experience a disorderly run-off due to legally binding close-out netting of those derivatives under master trading agreements.

(43) Authorities will consider and take all necessary actions to ensure effective resolution including removing obstacles to the separation of NTNI activities from traditional insurance activities during a stressed event. The resolvability assessment will include assessing whether, and the extent to which, effective ex ante separation of activities is in place. See section 3.3.4 Effective Separation of NTNI activities.

(44) The Key Attributes provide guidance to assist authorities in implementing the requirements for G-SIFIs. The IAIS concurs that these requirements are also relevant for G-SIIs, although insurance specificities need to be taken into account in implementing them. The IAIS also considers that the Key Attributes assessment methodology being developed by the FSB should contain insurance-specific elements and is therefore working closely with the FSB to ensure that the methodology addresses insurance specificities.[29] Insurance specificities which need to be taken into account, include:

- Plans and steps for separating NTNI activities from traditional insurance activities;
- The possible use of portfolio transfers and run off arrangements as part of the resolution of entities conducting traditional insurance activities; and
- The existence of policyholder protection and guarantee schemes (or similar arrangements) in many jurisdictions.

(45) The IAIS will also develop a template for assessing the resolvability of G-SIIs. This template could assist authorities in identifying structural measures that would better prepare G-SIIs for resolution if the G-SII needs to be resolved. The issues discussed under the previous section 3.3.2 on effective separation should also be considered in this context. In particular, the issue of reputation risk in terms of financial support without any legal obligation should be investigated for all material entities of a G-SII either in terms of business volume or of the systemic importance of the operation.

[29] E.g. Particularly in Key Attribute 3.5 (Bail-in), the financing conditions of the insurance business model and in Key Attributes 3.2 (xii) and 4.3 (i), the timeframes warranted for insurance contracts (and derivative contracts etc.) need to be taken into account.

3.5 Loss Absorption (LA) capacity – Applicable to all group activities

(46) As a foundation for HLA requirements for G-SIIs[30], the IAIS will as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the end of 2014.

(47)

3.6 Higher Loss Absorption (HLA) capacity – Applicable to NT and NI activities

3.6.1 General description and purpose

(48) G-SIIs should have higher loss absorption capacity to reflect the greater risks that they pose to the global financial system and the global economy. As stated in Section 2.2 above, the objectives of these policy measures for G-SIIs are to reduce the probability and impact on the financial system from distress or failure, and to discourage firms from becoming more systemically important. One direct policy measure to achieve these two objectives is the requirement to hold more capital – that is, to require HLA capacity.

(49) The desired outcomes of HLA capacity, all of which work to reduce the probability of distress or failure and thus the expected impact, include:

- Internalising some of the costs to the financial system and overall economy, which are otherwise externalities to the insurance group that occur as a result of a G-SIIs distress or failure by making G-SIIs more resilient to low probability, high impact events;
- Allowing for earlier supervisory intervention and more time to address emerging risks to the financial system;
- Providing disincentives to carrying out activities that pose a threat to the financial system; and
- Offsetting any benefit should it arise, such as lower funding costs, associated with the G-SII status.

(50) For non-regulated financial entities the requirement of HLA will mean that they must also be subject to "loss absorbency" or base capital requirements. These should be the backstop capital requirements or the Basel III rules if the entity's activities fall within the scope of Basel III. This will result in a more level playing field across G-SIIs and G-SIBs and prevent regulatory capital arbitrage.

(51) Group-wide supervisors also may consider the use of regulatory restrictions and limitations to achieve reductions in systemic risk. If restrictions and limits reduce systemic risk sufficiently that the insurance group is no longer deemed a G-SII, then it would eliminate the need for HLA as well as other G-SII related requirements.

(52) The method of calculating the amount of required HLA may take into account whether the insurance group has demonstrated effective separation. Wherever the

[30] Application of LA to non-G-SIIs is outside the scope of this document.

G-SII can demonstrate effective separation of NTNI activities from traditional insurance activities, the HLA uplift may be calculated based on the base capital requirements for the NTNI activities conducted. This is in line with the principle for HLA to be targeted, where possible, at activities that have the potential to generate or aggravate systemic risk. Where NTNI is not effectively separated, and some insurers will choose not to do so, if group-wide supervisors allow, then the HLA uplift may be calculated according to the base capital requirements of NTNI activities in the combined insurance entities and the interconnectedness score.

(53) The approach taken to achieve HLA capacity recognises that there is no current global accounting or solvency standard for insurance groups. As such, HLA will initially be based on the backstop capital requirements until a more comprehensive framework is established. For the purpose of this document the delineation of base capital requirements is described below.

(54) The HLA assessment may take into account any capital charges imposed by a national regulatory framework to mitigate the systemic risk of that insurer.

3.6.2 Methodology for calculating the HLA "uplift"

<u>Components of HLA</u>

(55) Building on the LA capacity requirements described above (until a more comprehensive framework is available) and after public consultation, the IAIS will develop by the end of 2015 the implementation details for HLA that will apply to designated G-SIIs, taking into account a sufficient transitional period for the introduction of this measure. HLA implementation is scheduled to begin from 2019 (see section 4). The IAIS will also consult on related issues (including the scope of the G-SII group on which HLA will be assessed).

(56) HLA may be calculated as the multiplication of two components: the required base capital amount and a percentage uplift or increase to that base capital. The base capital requirement may be based on the amount of NTNI activities, excluding non-financial activities. Note that this approach assumes that all NTNI activities are subject to some base capital requirement. In this manner, the capital uplift is focused on those activities that are the most direct drivers of systemic importance. While traditional and non-financial activities do not directly impact the HLA requirement, they do indirectly impact the HLA calculation via the interconnectedness score of the group.

A. Base Capital Requirements

(57) The base capital requirements (LA capacity requirements) will vary based on the type of activity and the type of entity the activity is being conducted in. It will typically take one of three forms, until a more comprehensive framework is developed:

1. *Insurance entities* - The base capital is the proposed backstop capital requirements.

2. *Non-insurance financial entities for which Basel III rules apply* - The base capital is the required capital under Basel III rules.

3. *Non-insurance financial entities for which Basel III rules do not apply* - The base capital is the proposed backstop capital requirements.

B. Percentage Uplift

(58) The uplift may be applied to G-SIIs' NTNI activities and may create incentives for G-SIIs to separate their NTNI activity and reduce their interconnectedness where practicable. The calibration of the HLA uplift will be considered provisionally after the backstop capital requirements are determined and then it will be reconsidered once the comprehensive framework is available.

Non- Effective Separation of NTNI activities

(59) In the case of entities that are not effectively separated, the percentage uplift may be determined according to a formula that is based on the G-SII's interconnectedness score from the assessment process.

Effective Separation of NTNI activity

(60) The risk to the financial system posed by activities undertaken by effectively separated entities is considered less than that posed by the same activities undertaken by entities that have not been effectively separated. The premise of this approach is that effective separation will reduce the transmission of the effects of distress or failure to the financial system and broader economy.

(61) In the case of NTNI activities in effectively separated insurance entities, the percentage uplift may be lower than for non-effectively separated activities.

3.6.3 Location of HLA

(62) In the case of effective separation, the capital uplift should be held at the separated entity or entities where the systemically risky activity is being conducted.

(63) Where the insurance group has not undergone effective separation, the group-wide supervisor in consultation with members of the supervisory college should require the uplift to be located where it will do the most good at reducing the expected systemic impact. As guidance in this decision, supervisors should consider the fungibility of capital, (the ability to move capital across jurisdictions and between entities), and the consequences for effectiveness in internalising the costs of undertaking activities that have a potential systemic impact. In addition, the decision over where to locate the HLA should account for whether the group-supervisor or the college has any authority over the non-regulated financial subsidiaries. For example, the HLA may need to be held at the holding company because of the lack of prudential regulatory authority to require it at the non-regulated operational subsidiary.

3.6.4 Acceptable instruments

(64) Currently, there is no common global definition of capital in the insurance sector. ICP 17.11.34 provides an example of broad categorisation of capital as follows:

a. Highest quality capital: permanent capital that is fully available to cover losses of the insurer at all times on a going-concern and a wind-up basis.
b. Medium quality capital: capital that lacks some of the characteristics of highest quality capital, but which provides a degree of loss absorption during on-going operations and is subordinated to the rights (and reasonable expectations) of policyholders.
c. Lowest quality capital: capital that provides loss absorption in insolvency/ winding-up only.

(65) The FSB report[31] endorsed at the G20 Seoul Summit in November 2010 states that G-SIFIs should have greater loss absorption capacity whereby a higher share of their balance sheets is funded by capital or by other instruments which increase the resilience of the institution as a going concern.

(66) In line with the FSB recommendation, given the going-concern objective of the HLA capacity requirement, the HLA capacity should be met by the highest quality capital as defined in the above-mentioned ICP 17.11.34. Instruments comprising the highest quality capital – that is permanent capital that is fully available to cover losses of the insurer at all times on a going-concern basis – are the appropriate instruments to meet a HLA capacity requirement for the time being.

[31] FSB, The Seoul Document, November 8, 2010 and FSB Progress since the Washington Summit in the Implementation of the G20 Recommendations for Strengthening Financial Stability,

4. Implementation

4.1 Implementation timeframe

(67) The starting point for the implementation of G-SII policy measures is the determination by the FSB and national supervisory authorities, in consultation with the IAIS, that a particular insurer is found to be a G-SII. For each G-SII, the group-wide supervisor would contact the G-SII to commence the process of implementing required policy measures. The key dates, timeframes and respective actions required (or intermediate activities) are outlined below:

Key Implementation Dates and Timeframes	Action required (or intermediate activity)
July 2013	The FSB to designate the initial cohort of G-SIIs based on the IAIS methodology using 2011 data (with annual updates thereafter published by the FSB each November, beginning in 2014) For designated G-SIIs, implementation commences of resolution planning and resolvability assessment requirements of the FSB Key Attributes of Effective Resolution Regimes and enhanced supervision, including group-wide supervision
October 2013	IAIS to prepare a workplan to develop a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard
July 2014	Crisis Management Groups (CMGs) established for the initial cohort of designated G-SIIs IAIS to provide the FSB with a recommendation on the G-SII status of, and appropriate risk mitigating measures for, major reinsurers
July 2014	Systemic Risk Management Plan (SRMP) to be completed
September 2014	IAIS to finalise straightforward, backstop capital requirements (loss absorbency – LA) to apply to all group activities, including non-insurance subsidiaries
End 2014	Recovery and resolution plans, including liquidity risk management plans, for the initial cohort of designated G-SIIs to be developed and agreed by CMGs
End 2015	IAIS to develop implementation details for HLA that will apply to designated G-SIIs starting from 2019
July 2016	Implementation of SRMPs to be assessed
November 2017	The FSB to designate the cohort of G-SIIs, based on the IAIS methodology and 2016 data, for which the HLA policy measure will apply, with implementation beginning in 2019
January 2019	G-SIIs designated in November 2017 to apply the HLA requirements

(68) Discussions with the G-SII would focus first on the particular drivers of G-SII status. The group-wide supervisor would immediately begin to implement measures with regards to enhanced supervision (including development of the SRMP) and effective resolution. Recovery and resolution plans (RRPs), including liquidity risk management plans, should be developed and agreed by crisis management groups (CMGs) by the end of 2014. The SRMP should be completed within 12 months after G-SII designation for the first group of G-SIIs. The implementation of the SRMP should be assessed by the authorities 3 years after G-SII designation

(69) Regarding the proposed policy measures on HLA, the IAIS will develop and specify a concrete plan by early 2015 on HLA and on related issues (including the scope of the G-SII group on which HLA will be assessed). An impact assessment of the proposed levels of HLA will be conducted to assist the IAIS and FSB to better understand the various implications for insurers that are designated as G-SIIs. Public consultation on proposed policy measures on HLA is scheduled during 2015.

(70) The HLA capacity requirements will apply from 2019 for those G-SIIs designated in 2017 and will be based on the status of implementation of the SRMP in 2017. The list of designated G-SIIs will be updated every year. After the G-SII designations in 2017, a newly designated G-SII will be allowed to have the same period to meet the HLA capacity requirement.

(71) The IAIS expects national authorities to prepare a framework in which insurers will be able to provide high quality data for the indicators in the G-SII assessment methodology. To ensure the transparency of the methodology (for the benefit of market participants and to promote market discipline) and the efficient identification of G-SIIs, the data used should ideally be made public. The IAIS will work with participating authorities to enable such publication over the coming years.

(72) Implementation of G-SII policy measures should be monitored by an IAIS peer review process in order to ensure international consistency.