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**Comments to the  
International Association of  
Insurance Supervisors  
Regarding Requirements for Global  
Systemically Important Insurers**

COMMITTEE ON INSURANCE LAW

JANUARY 2014

NEW YORK CITY BAR ASSOCIATION  
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# IAIS Consultations

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## Q-Nr. Reference Question

### 2. Executive summary

<b>Q-1</b>	<b>2.</b>	<b>General Comments on Executive Summary</b> <p>The Committee on Insurance Law ("Committee") of the New York City Bar Association ("Association") is pleased to provide this response to the IAIS's comment solicitation on its BCR proposal. The Committee's comments are intended to share a U.S. perspective on the BCR proposal for G-SIIs, particularly in light of ongoing developments in insurance regulation in this country affecting capital standards, systemic risk and group solvency. These developments can, we believe, inform the process of regulating internationally active insurers more broadly. The Association is a not-for-profit, voluntary association of 24,000 lawyers practicing in New York City, which provides members the opportunity to meet and consult on various legal and public policy issues, acquire continuing education and professional development and advocates for equal administration of justice, among its many activities. The Committee comprises lawyers representing a diverse cross-section of the insurance community, including lawyers in private practice, in-house counsel at insurance carriers and producers across multiple lines of insurance business, trade association officials, regulators, policyholder lawyers, insurance arbitrators and other types of insurance professionals. This letter represents the views of the Committee as a whole and not necessarily those of any particular member thereof. (Committee members Robert Easton, Executive Deputy Superintendent of Financial Services for the State of New York, and Joana Lucashuk, Senior Attorney with the Department of Financial Services for the State of New York, have recused themselves from all Committee deliberations on these comments.)</p>
<b>Q-2</b>	<b>2.1</b>	<b>Comments on Overview</b> <p>The IAIS is to be commended for noting the inappropriateness of using bank capital standards such as Basel III for insurance companies. We would suggest that Overview be revised to more clearly articulate the intention or scope of the project, for instance explaining what exactly a "basic capital requirement" is in this context. It is not altogether clear, for instance, whether this refers to an amount of assets, some percentage or ratio or other metric. Furthermore, the proposal's use of jargon such as "backstop" (passim), "front-stop" (¶12) and "higher loss absorbancy" (id.), without further explanation, does not clearly convey the substance of the kind of capital requirements contemplated by this proposal as a whole.</p>
<b>Q-3</b>	<b>2.2</b>	<b>Comments on Approach</b> <p>The "factor" based approach, which bears some similarity to the U.S. state-based risk-based capital ("RBC") regime, is, we believe, a sensible and sound framework for measuring capital adequacy. In terms of the factors described in this section, we note the following: (1) The IAIS should describe with more specificity what it perceives to be "non-traditional" and "non-insurance" risks insofar as these terms are not self-evident. (2) It is similarly not clear what the IAIS means when it writes that "operational or liquidity" risks are not within the scope of the BCR (¶18). Given that operational and liquidity needs of an enterprise are closely connected with the availability of its capital resources, we do</p>

not understand why these have been disaggregated and deferred.

**Q-4**      **2.3**      Comments on Generic example

The operative terms in the formulas should be more specifically defined so that the full impact of the example can be understood.

**Q-5**      **2.4**      Comments on Key risks addressed

We reiterate our comment above in the response to Q.3, which is to query why operational and liquidity risks have been expressly excluded from this project.

**Q-6**      **2.5**      Comments on Other Considerations

We note with approval the IAIS's conclusion in ¶29 that "the use of the Basel III Leverage Ratio for G-SIIs is not appropriate."

**Q-7**      **2.6**      Comments on Conclusion and next steps

The time frame is probably ambitious since this first round of comments is likely to generate many questions on the meaning of the terminology used and other areas. More substantive comments will appear as the terminology is refined and concepts are developed. The U.S. experience with coordinating multiple regulatory regimes suggests to us that it is likely that more than two rounds of comments will be needed to build consensus. In the longer term, we note that the BCR will necessarily have to be applied in a way that gives effect to individual countries' laws and procedures. Otherwise, there may be no effective enforcement mechanism. Perhaps some system of national reciprocity would be a useful possibility, in which a particular country would recognize the capital adequacy of a foreign G-SII only if (1) the G-SII's domiciliary country applies the BCR standard, or (2) in the event that the domiciliary country does not apply the IAIS, the G-SII satisfies BCR as applied by the foreign country.

### 3. Context

**Q-8**      **3.**      General Comments on Context

Our comments in Section 3 set forth below relate to the objectives of the BCR initiative and to some of its empirical components.

**Q-9**      **3.1**      Comments on Background

Section 3.1 ("Background") is largely historical in nature; we have no comments on this.

**Q-10**      **3.2**      Comments on The BCR mandate

An overarching issue we have in this item relates to the stated goal, included in the BCR mandate, that "G-SIIs continue as 'going concerns.'" In the ordinary course of insurance regulation (in any jurisdiction), we believe that laws and regulators should endeavor to create a sustainable, competitive insurance marketplace but not to assist particular insurers. The neutral laws and regulations governing financial condition (for example, RBC in the U.S.) do not inherently favor or disfavor any particular firm. The explicit goal that G-SIIs "continue" as "going concerns" seems to frustrate this objective. We understand that outside the U.S., there may be less hesitancy about government interventions as a means to assist failing firms, and we are also mindful that the stated goal may refer to the financial health of the sector more broadly and not to individual firms. In any event, we would urge heightened caution in formulating rules with the express and stated goal of preserving or "continuing" G-SIIs. We believe that the preferential treatment of identified companies, or the perception of such, could put other insurers at competitive disadvantage and introduce other market distortions. Although our preference would be to delete this goal from the BCR proposal, in recognition that the public policy goals of countries will differ, perhaps an alternative goal of liquidating a G-SII should be included together with a discussion of the protections available to policyholders following liquidation (as one example, under the Guaranty Associations of the individual U.S. states).

**Q-11**      **3.3**      Comments on Scope of application

We have no comments with respect to scope of application.

**Q-12**      **3.4**      Comments on Principles

To the extent that a unified, global capital standard is appropriate and feasible for G-SIIs to begin with (from an accounting and regulatory perspective), we respectfully submit the following views on the underlying principles for such a standard. Our comments on Section 3.4 relate to Principles 2, 5 and 6. Our comments on Principles 2 and 5 are related insofar as these two items appear to address similar objectives. It is almost axiomatic that two G-SIIs measured for BCR should be measured according to uniform criteria. However, it is not clear to us whether this means that the IAIS intends to give effect to, or alternatively, to disregard differences that may arise between geographical areas. For example, in some jurisdictions, pensions are considered part of the insurance business and are regulated and marketed as such. In other jurisdictions, this is not the case. Would such business be considered “NTNI” in the latter but not the former? Or would the BCR standard itself contain guidelines for what is considered part of the insurance business? Any of these outcomes could be sound and justifiable, but the general principle of “consistency” does not provide any clarity in articulating how differences will be harmonized, and essentially begs the question. Similar examples of this issue could be constructed with respect to security valuations, investment restrictions, reinsurance collateral requirements, underwriting criteria and innumerable other variations in national treatment of insurers. As to Principle 6, we would seek additional clarification as to what is meant by “use of public data.” To the extent that this suggests that the results of the BCR process should be made public for a given entity, we would urge heightened caution in implementing this principle. In the U.S., while RBC results are included in statutory reporting and thus publicly disclosed, the various inputs, calculations, projections and plans used to determine the results are confidential. This seems appropriate insofar as the RBC instructions require granular, highly quantitative determinations on all aspects of the insurer’s business. These determinations are effectively in the nature of trade secrets, the disclosure of which could cause competitive harm to the insurer or otherwise expose it to business or litigation risks. Whatever benefits may be associated with disclosure in this instance, we believe, are outweighed by such consequences. We note also the heightened confidentiality protections that the NAIC has built in to the new “Own Risk Solvency Assessment” and Form F (Enterprise Risk Management) requirements. We would suggest considering the foregoing factors – and in general the U.S. sector’s experience with RBC requirements – in crafting the disclosure requirements applicable to G-SIII capital benchmarks.

**Q-13**      **3.5**      Comments on Role of a “basic” BCR

We reiterate our concern that the interplay between BCR and HLA is not self-evident. The term “HLA uplift” should be clarified. Furthermore, the concept of “High Loss Absorbency” may not be as relevant in this context as it is for, say, banks. We note that under U.S. state laws, obligations to policyholders are senior to virtually any kind of funding instrument that an insurer can issue, whether characterized as “debt” or “equity”. Therefore, in a typical insurance company in the U.S., any stock or debt issued by it will “absorb losses” ahead of policyholders, making the concept of loss absorption perhaps less meaningful. Finally, we do not understand, and would seek clarification of, the following sentence in the 4th bullet of paragraph 58 of the proposal: “Another implication of the more straightforward nature of a backstop is that it becomes inherently less reflective of risk profile differences between G-SIIs.”

**Q-14**      **3.6**      Comments on Qualifying capital resources

The distinction between core and additional capital likely does not provide enough clarity to determine how specific instruments should be characterized. The capital markets have developed myriad products designed to qualify as equity for regulatory or rating agency purposes but debt for other purposes (e.g., taxes). By introducing the distinction between two types of equity instruments (core and additional), the IAIS may unwittingly be creating the potential for ambiguities here. Instead of aspirational principles such as “available,” “free of mandatory distributions” and the like, the IAIS should consider more granular rules distinguishing core from additional capital. For instance, the IAIS should explain, among other things, (1) how “subordinated” an instrument must be in order to be counted as core or additional (e.g., could an instrument be senior to common equity and still qualify as core capital? Would the answer depend at all on whether the insurer was a non-stock entity?); (2) whether a dividend stopper over a certain period of time would qualify as “free from mandatory distributions;” and (3) whether the presence of a “replacement capital covenant” (as became commonplace in many bank hybrid security offerings in the 2000s) would affect the status of a capital instrument.

**Q-15**      **3.7**      Comments on Non-insurance activities

No comments.

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## 4. Comparability of valuations

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<b>Q-16</b>	<b>4.</b>	General Comments on Comparability of valuations	We have no particular comments on Section 4. We would reiterate that, to the extent that Section 4 raises discrepancies between jurisdictions as an issue, our concerns expressed in Q.12 seem equally applicable.
<b>Q-17</b>	<b>4.1</b>	Comments on Valuation of liabilities – current estimates	The ICP standard 14.8 appears to be focused on the future cash flow risks in life insurance or derivative type lines of business. Other risks such as mortality, frequency, severity and others present in both life and non-life lines of business will have to be incorporated in insurance liability valuation.
<b>Q-18</b>	<b>4.2</b>	Comments on Valuation of assets	The second bullet of footnote 26 may not be correct. Even if a pool of assets is initially matched to a pool of liabilities on day 1 then market volatility will mean that they are no longer matched on day 360 or day 720, for example.

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## 5. Factor-based approach

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<b>Q-19</b>	<b>5.</b>	General comments on Factor-based approach	As stated earlier, we endorse a factor-based approach. To the extent that Section 5 sets out generic examples of how BCR level would be determined, and discusses the general application of factors and “levels of granularity,” we generally support these approaches as outlined, noting that they are broadly stated and in need of refinement in order to be actionable. We view the discussion of “next steps” as purely logistical and administrative.
<b>Q-20</b>	<b>5.1</b>	Comments on Context	Again, we concur with the observation that Basel III should not apply to insurers and that leverage ratios are unlikely, in and of themselves, to be useful tools for evaluating the adequacy of G-SIIs.
<b>Q-21</b>	<b>5.2</b>	Comments on Major risks	No specific comments.
<b>Q-22</b>	<b>5.3</b>	Comments on Factor-based approach calculation	No specific comments.
<b>Q-23</b>	<b>5.4</b>	Comments on Level of granularity	No specific comments.
<b>Q-24</b>	<b>5.5</b>	Comments on Generic example	No specific comments.
<b>Q-25</b>	<b>5.6</b>	Comments on Field testing process	No specific comments.
<b>Q-26</b>	<b>5.7</b>	Comments on Next steps	The schedule seems highly compressed considering the amount of work that needs to be done. The U.S. experience in producing uniform regulations among the 50 states informs us that the process will take longer and require more rounds for comment. In another example of this type of process, the Basel Committee on Banking Supervision was formed in 1974 but did not publish its capital standards until 1988. While 14 years is too long, we respectfully submit that the proposed schedule may be too ambitious.

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## General Questions

**A second consultation in mid-2014 will specifically invite comments on a range of questions regarding the BCR and its relationship with other existing and proposed regulatory measures affecting G-SIIs and Internationally Active Insurance Groups (IAGs). You may comment below if you wish to provide input on any of these general questions in advance of the second consultation:**

<b>Q-27</b>	<p>1. Is the purpose of the BCR clear enough?</p> <p>We believe that additional clarification of the role of BCR, and in particular its relationship to HLA requirements, would be very helpful.</p>
<b>Q-28</b>	<p>2. At what level should the BCR be calibrated compared to existing national benchmarks?</p> <p>The question is not altogether clear to us because we understand the BCR to be a trans-national standard. While BCR should have an internal consistency (which itself presents challenges, as discussed elsewhere herein, particularly in our responses to Q.12 and Q.16), we do not understand the motivation for or feasibility of “calibrating” any BCR results to national benchmarks.</p>
<b>Q-29</b>	<p>3. Is the BCR expected to be a temporary measure, until the risk-based group-wide global insurance capital standard (ICS) is in place, or will it continue to apply?</p> <p>In view of the significant management resources that an insurance group must devote to determining and monitoring its compliance with capital standards, ICS should replace BCR not supplement it or apply simultaneously. Also see our response to Q.30.</p>
<b>Q-30</b>	<p>4. Should a backstop capital measure be introduced to complement the proposed ICS, in addition to or instead of the BCR? If so what should the purpose of such a backstop capital measure be, compared to the BCR?</p> <p>Regardless of whether a “backstop” capital measure is implemented to “complement” the ICS, any co-existing ICS and BCR rules should be fully integrated with each other (and also integrated with any distinct HLA requirements).</p>
<b>Q-31</b>	<p>5. Will the proposed approach to valuation of assets and liabilities provide sufficient global comparability?</p> <p>We express no view at this time.</p>
<b>Q-32</b>	<p>6. Can a reasonable balance of risk sensitivity and simplicity be achieved using a factor based approach?</p> <p>Yes, subject to the various concerns raised in this response.</p>
<b>Q-33</b>	<p>7. How should the BCR be integrated into national or regional frameworks which are in the process of being implemented or modified?</p> <p>We express no view at this time. We await the IAIS’s ideas on this, which may be more timely once the BCR is more fully developed.</p>
<b>Q-34</b>	<p>8. How should supervisors enforce the BCR in a consistent manner across jurisdictions?</p> <p>As discussed in our responses to Q.12 and Q.16, the issue of discrepancies between jurisdictions is existential to the success or feasibility of a BCR regime. It is incumbent on the IAIS, insofar as it is purporting to develop a trans-national standard, to articulate and defend a proposed treatment of these disparities in a way that respects the jurisdiction of individual countries and states.</p>