

Dr. Therese M. Vaughan
Chair
The Joint Forum
Bank for International Settlements (BIS)
Basel

March 16, 2012

Dear Dr. Vaughan:

Subject: Joint Forum consultative report - Principles for the Supervision of Financial Conglomerates

Introduction

The undersigned insurance associations, as members of the International Network of Insurance Associations (INIA) and representing a significant portion of the world insurance industry, welcome the opportunity to provide views and comments on the consultative report of the Principles for the Supervision of Financial Conglomerates issued by the Joint Forum (“Principles”).

The purpose of this new release is to update the current (1999) principles by reflecting the recommendations provided by the Financial Stability Board in the “Differentiated Nature and Scope of Financial Regulation” regarding the need for the Principles to address industry developments. In this respect, the Joint Forum suggests the inclusion of unregulated entities in the scope of supervision, such as special purpose vehicles and other off-balance sheet entities, holding companies, third party participants and minority interests.

General comments

We appreciate the consistency between the proposed Principles and the current ones in setting up the overall architecture of financial conglomerate supervision on the basis of the same essential elements: the detection and correction of multiple uses of capital, appropriate group risk management and the avoidance of regulatory arbitrage.

We support the notion that only those risks that arise from cross-sectoral activities and potential loopholes and gaps in sectoral supervision should be addressed by specific financial conglomerates’ supervision. This also means that principles for the supervision of conglomerates should not lead to duplication and multiple supervisory procedures. The applicability of the Principles should be qualified to properly take into account the capacity of sectoral level supervisors, either for groups or for solo entities, acting in coordination with one another, to establish appropriate and effective conglomerates supervision. Therefore, the Principles should only apply to situations that are not dealt with by sectoral supervision.

We also support the aim to foster efficient and effective supervision of financial conglomerates across the different regions of the world, with particular attention to those active across borders. Moreover, there are provisions that should assist in accomplishing that objective while avoiding duplication, protecting confidentiality and assuring a transparent process.

We believe that the Principles should be high level so as to leave adequate room for implementation in the local regulatory and supervisory approaches. However, in our opinion, there are some areas where a more precise description and wording would be useful in order to optimize the effectiveness of the principles. For example, we note that footnote 11 mentions that the concept of ‘material’ will be defined at a later stage. We appreciate this commitment and look forward to participating in this exercise. Furthermore, in order to properly assess whether “level playing field” issues could arise, we would like to better understand to what extent the ‘degree of national discretion in approaches to conglomerate supervision’ as referenced in the Principles is envisaged.

With respect to the envisaged scope of application of the Principles, we have concerns about the proposed supervision of minority interests and holding companies. Specifically, while we support the application of the principle of dominant influence, we strongly believe that the inclusion of other types of minority entities should be handled on a contingency basis and not as a rule.

Supervisory powers and authority

We see merit in exploring how to enhance coordination and communication among existing sectoral regulators. We also specifically endorse the language in this section concerning the importance of confidentiality and the need for clear responsibilities and objectives for all supervisors.

In line with our introductory remarks, we would like to emphasize that the reason for conglomerate supervisors to have additional tools for coordination and cooperation is to deal with risks that arise from financial institutions belonging to two or more sectors within the same group or from the inclusion of non-regulated entities. Having this in mind, Principle 9 should provide a mechanism for existing sectoral regulators to work together in a coordinated and streamlined fashion to take corrective action under existing regulatory regimes. Moreover, we would like to point out that as a result of this proposed extension of the scope of supervision, an issue concerning the supervision of holding companies may arise. In some legislative frameworks, supervision is applied to authorized entities only, which means that supervision of the holding company as a stand-alone entity is not foreseen even if this entity may play a crucial role as a head of a group of authorized entities.

Supervisory responsibility

At the outset, we want to indicate our strong support for the language on efficient and effective regulation, confidentiality and a transparent process for rendering decisions.

In our opinion it should be left to the relevant authorities to develop and implement the appropriate legal provisions at a national level. The authorities themselves should develop supervisory programmes that specify the application of the provisions and actionable triggers. With regard to supervisory actions, the applicable law should be clear as to the standards for each action and provide a right of appeal.

We agree on the importance of information-sharing and supervisory coordination. We agree that a process be established to organize such cooperation and specify the roles and responsibilities of the different supervisors involved. Further details or guidelines about this information-sharing

process and contents should be provided. Clear and consistent confidentiality protections for sharing sensitive, non-public company information are critically important.

The Principles should recognize that each sectoral supervisor has available to it the range of enforcement tools established under domestic law and should encourage these supervisors, acting in coordination with the primary sectoral supervisor, to use these enforcement tools to address risks arising from cross-sectoral or unregulated activity. With reference to Principle 9, we suggest that, when appropriate, there ought to be consistency in the way wrongdoers are sanctioned, so that similar violations and weaknesses attract similar sanctions. We see merit again for the applicable law to provide a right of appeal. Moreover, multiple sanctions for the same wrongdoing should be avoided. Clear and objective criteria for enforcement should be established and publicly disclosed.

Corporate Governance

The Principles, implementation criteria, and explanatory comments are overly prescriptive in requiring a specific corporate governance framework. Corporate governance is an area characterized by important historic and cultural differences across borders, which in turn leads to different legislative approaches. Against this background it is important for the Principles to remain sufficiently general that these differences can be adequately taken into account. As an example, we do not support the proposed requirement to have the risk management function report directly to the board of the financial conglomerate. It is our view that each entity should be allowed to organize the reporting line of its risk management function according to its own structure of corporate governance. The important element here is to ensure transparency of the decisions and to implement appropriate communication processes.

Furthermore, references to requirements applying to the boards of directors (*e.g.*, in section 12(c)) should respect that these are subject to applicable local corporate law. In addition to that it remains unclear who “senior managers” are since they are referred to in 12(ii) next to the board members and key persons in control functions.

This being said, in our opinion several key terms should be more carefully defined, including “suitability”, so as to avoid subjective and contradictory determinations, “adequate oversight”, and “seek restructuring” to make clear that restructuring can certainly be discussed but not mandated.

Capital adequacy and liquidity

We support the fact that the Principles for capital adequacy are aimed to supplement principles for sectoral supervision where they don’t fully address the nature and scope of the financial conglomerate; however the Principles should be made to express clearly that they are not intended to endorse the establishment of a global standard for assessing capital adequacy.

We support also the focus on unregulated entities in the group-wide capital assessment. However, we propose that the implementation criteria 16(a) be amended by “if the group does not assess its capital position on a consolidated basis”, since assessing capital adequacy on a consolidated basis implies already covering all exposures within the group and encompassing all its entities. For the same reason, we find that implementation criteria 16(b) is not necessary if the capital adequacy is quantified and managed on a consolidated basis.

In the review of supervisory capital requirements, we agree that potential future capital injections and management actions should not be taken into account when setting an internal capital target. On the other hand, in our view all legally binding contracts, such as intra-group guarantees in line with the relevant sectoral framework, should be eligible. In any event, we recognize that local supervisors are able to know with certainty that the insurance legal entities they regulate have accessible capital in the locally established minimum capital amount, and we believe that relevant portions of the Principles should be qualified to embrace this understanding.

With reference to liquidity risk, we have concerns about how the Principles will be effectively implemented by supervisors. In any case, this is an example of the level of management of a company that should be beyond the scope of these principles.

According to explanatory comment 20.1, supervisors should have timely access to information concerning the wider group's liquidity position and risks to that liquidity position. This requirement goes further than principle no. 20, which only requires the head of the financial conglomerate to adequately and consistently identify, measure, monitor, and manage liquidity risks. As explanatory comments are supposed to provide guidance to principles only, they should not impose further requirements. We are concerned about the practicability of such requirement.

Furthermore, the principles of materiality/proportionality should be applied, especially in an area where the significance of the risk changes a lot according to the sector.

Risk Management

We support the proposal of a detailed policy requirement to deal with contagion risk and risk concentrations. However, we are quite concerned about the prescriptive standards contemplated by the principles related to risk management, including the proposal to introduce quantitative limits for risk-concentration and intra-group transactions and exposures. We suggest the removal of the prescriptive principles regarding risk management and leave these matters including the areas of cross-sectoral risk concentration from intra group transactions to the local sectoral regulators.

We are also concerned that some aspects may be overly intrusive, including possible new reporting, supervision regarding new business and required quantitative limits.

Sincerely,

American Council of Life Insurers (ACLI)
American Insurance Association (AIA)
Association of Bermuda Insurers and Reinsurers (ABIR)
Association of British Insurers (ABI)
Canadian Life and Health Insurance Association (CLHIA)
General Insurance Association of Japan (GIAJ)
German Insurance Association (GDV)
Insurance Bureau of Canada (IBC)
Insurance Council of Australia (ICA)
Insurance Europe
Property Casualty Insurers Association of America (PCI)
Reinsurance Association of America (RAA)