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FSOC ruling a concern for property/casualty insurers

By BusinessInsurance.com

WASHINGTON—Property / casualty insurers remain concerned about the Financial Stability Oversight Council's final rule on which nonbank financial institutions present a systemic risk to the U.S. economy and therefore are subject to heightened regulation.

The rule, which was published in the Federal Register last week and takes effect May 11, sets a three-step process for FSOC to follow in determining which nonbank entities present a systemic risk to the economy.

In the first step, a nonbank financial institution must have at least $50 billion in consolidated assets and meet at least one of several thresholds. These include having $30 billion in gross notional credit default swaps, having $3.5 billion in derivative liabilities and having $20 billion in total outstanding debt.

In the second step, FSOC will use a specific framework to make its determination of which companies fall into the category. Those companies deemed to present systemic risks will be subject to heightened examination in the third and final step to determine whether they should be subject to heightened regulation by the Federal Reserve Board of Governors.

The final rule closely resembles the proposed rule for nonbank financial institutions, and observers say that may raise issues for some insurers.

"The first concern is that some of the rules are still yet to be written," said Mike Nelson, chairman of Nelson Levine de Luca & Horst L.L.C. in New York, a law firm that focuses on insurance. He said any insurers determined to be systemically risky would face additional costs when subject to more intense regulation.

Mr. Nelson said property / casualty insurers are vastly different than commercial banks, and they manage their risks and finances completely differently.

Mr. Nelson also noted that insurers already are subject to regulation at the state level, so there is concern that the FSOC rule could create dual regulation.

“I think people are still kind of waiting for further clarification about the qualitative measures,” such as determining interconnectedness, that will be considered when determining the risk an institution presents, said Howard Mills, director and chief adviser of Deloitte Services L.P.’s insurance industry group in New York and a former New York insurance superintendent.

“I think the industry is still kind of where it was before,” Mr. Mills said. While the expectation is that FSOC is “unlikely to give the insurance industry a pass,” the list of affected insurers will probably be “very short,” he said.

But if the criteria change, other insurers could be added to the list. “What happens in the future with mergers and acquisitions and insurers get bigger? We still don’t know,” Mr. Mills said.

“There’s always going to be concerns when you’re talking about a federal agency or group having the authority to impose itself on a private company,” said Jim Grande, senior vp in the National Assn. of Mutual Insurance Cos.’ Washington office. “We would have preferred that FSOC exclude property/casualty companies from being able to be systemically significant.”

He also said the Federal Insurance Office’s role in the process should be better defined. FIO can recommend to the FSOC that an insurer be designated as systemically significant, he said. “What we don’t know is if FIO is bound by all of the same criteria and rules FSOC is.”

“Certainly, a few insurers will be captured under the rule,” said Ben McKay, a senior vp in the Washington office of the Property Casualty Insurers Assn. of America. He said the issue remains whether designation is a “scarlet letter” or a sign of an implicit federal backstop for the institution.

Mr. McKay also questioned how the U.S. process will relate to an international process to determine systemic significance that is supposed to be issued later this year by the Financial Stability Board of the Group of 20 nations.

“We’re concerned that the two rules are parallel,” he said. “There’s a lot of concern about what it means to be on each and what it would mean if you’re on one and not the other.” Mr. McKay said PCI would prefer that the United States “push its regulations out to the world.”

“I think it will be a wait-and-see” situation, said J. Stephen Zielezienski, senior vp and general counsel of the American Insurance Assn. in Washington. “There were a couple adjustments to the metrics. We’re pretty comfortable—if in Stage 1 you apply those metrics to regulated property/casualty insurers, you’re not likely to get any that trigger those plus-one metrics.”

But he also noted that the FSOC declined to eliminate its residual authority to subject some companies to review even if they do not meet the metrics set out in the first stage of the process.

“We’ll have to see how it plays out,” he said.