 By Peter H. Bickford

Too Big … To Succeed!

"An essential aspect of creativity is not being afraid to fail." Edwin Land

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At this time of year we are bombarded by images of Mother Nature at her most traumatic and beautiful moments. Blizzards and ice storms mixed with bucolic and tranquil winterscapes. One of the more iconic seasonal images is of a youngster so bundled up against the elements by overprotective parents that he or she can barely move – so bundled that frolicking in the snow and enjoying the elements is out of the question. This image keeps coming to mind when following the national and international efforts to "protect" the public from failed financial institutions, including insurance companies.

As 2014 rolls into 2015, there is a marked increase in alarms and warnings about preparations for the impending Solvency II capital regime scheduled to go into effect next year. Stress tests are being performed and predictions abound about the readiness for a new, stricter regulatory and capital regime. Regulatory officials in other jurisdictions scramble to ensure that their regimes are "substantially equivalent" jurisdictions so that their domestic companies can continue to operate in Solvency II jurisdictions.

Likewise, the International Association of Insurance Supervisors (IAIS) continues its steady march toward a consolidated risk-based insurance capital standard (ICS) for global systematically important insurers (G-SIIs) and internationally active insurance groups (IAIGs). And in the US, the Financial Stability Oversight Council (FSOC), whose voting members include only one with any insurance background, has now designated four entities as strategically important financial institutions (SIFIs) subject to enhanced oversight and capital standards by the Federal Reserve. (For a background of these and other insurance regulatory initializations and acronyms, see my **Insight** column, "*Alphabet Soup*" in the August 18, 2014 issue of **IA**.)

Steve Hearn, deputy chief of Willis and chairman of the London Market Group, commenting on the Group's study, succinctly summarized the current push by regulators by noting that the Prudential Regulatory Authority in the UK "is attempting to use the introduction of Solvency II to drive to a zero failure regime, with firms forced to significantly overcapitalize." By attempting to eliminate any foreseeable possibility of failure, regulators are removing any semblance of traditional risk sharing at reasonable costs, and stifling any element of innovation or product development.

Another side effect of this capital oriented regime is the likelihood of a significant increase in merger and acquisition activity among insurer groups as mid-sized companies seek to lessen the cost and burden of increasing capital requirements that only the biggies can meet. The irony is that as regulators push for more stringent capital requirements encouraging larger and larger companies, these larger and larger companies risk being determined to be "too big to fail," requiring even more capital and oversight.

The industry has made some efforts to push back against these developments. Most notable is Met Life's recent lawsuit against its designation as a strategically important financial institution by the FSOC, arguing that the designation will have an adverse effect on Met Life's ability to compete in the marketplace. In addition, as a result of industry pressure, this past December Congress passed (yes, that Congress!) and President Obama signed legislation making it clear that the Federal Reserve is not required to apply bank-based risk and leverage capital requirements on insurance companies subject to its oversight (i.e., strategically important financial institutions). The international push for greater financial control over insurers in the name of security, however, has hardly been slowed by these efforts.

While companies are being increasingly overprotected against the elements, the real victims are innovative and competitive products for customers. Rather than being "too big to fail," companies are becoming "too big to succeed"!

Meanwhile, many in the industry continue to be obsessed with the issue of State v. Federal regulation of the business of insurance. Take, for instance, the reaction of many to the Federal Insurance Office (FIO) report on reinsurance issued in December. The report is a comprehensive summary of the reinsurance business, including sections on the history, purpose and importance, and regulation of reinsurance, and on global reinsurance markets. It is seemingly nothing more than its title suggests it to be: an examination of "the breadth and scope of the global reinsurance market and the critical role such market plays in supporting insurance in the United States." It is a well-written and well-documented presentation with substantial cites to industry and NAIC studies

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and materials leading to the inevitable observation that: "The strength and viability of both the insurance and reinsurance sectors are vitally important to the United States, which is the largest single-country insurance market in the world."

However, even though the report makes no specific recommendations, critics point to one statement in the conclusion of the report that "proves" that the FIO's intent is much more insidious. The statement raising the hackles of many is: "In light of the importance of the global reinsurance market to U.S. insurers, and for other reasons described in this Report, Treasury and USTR [Office of the US Trade Representative] are considering a covered agreement with respect to collateral requirements for reinsurers."

Sound the alarm and circle the wagons!! The Feds are about to preempt state reinsurance laws and regulations! Once they start with the patchwork of state collateral rules, it is only a matter of time before they take over full oversight over reinsurance as well as insurance.

Why isn't the disappearance of the reinsurance business in the US the headline rather than the possible Federal proposal of uniform nationwide collateral requirements?

The most amazing aspect of this media attention to this one small piece of the report is the lack of any discussion whatsoever of some of its key undeniable factual observations. For instance, why isn't there more concern over the report's highlighting of the fact that the share of premiums ceded by U.S. insurers to U.S.-based reinsurers declined from 61 percent in 1997 to only 38 percent in 2013? Or that reinsurers owned by groups headquartered or domiciled outside the U.S. accounted for approximately 92 percent of reinsurance premiums ceded by U.S.-based insurers in 2013? Or that other than U.S. subsidiaries of offshore companies, no new U.S.-domiciled reinsurers have been formed in over two decades? Why isn't the disappearance of the reinsurance business in the U.S. the headline rather than the possible Federal proposal of uniform nationwide collateral requirements?

The State v. Federal ship sailed long ago. The Feds have what they want – control over financial requirements – and are happy to leave the day-to-day regulatory issues to the states. Let's move on and deal with the real issue: how to save the U.S. reinsurance industry from extinction. [IA]