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US – Dodd-Frank: Title II Orderly Liquidation Authority

On 18 January 2011, the Federal Deposit Insurance Corporation (**"FDIC"**) issued an interim final rule (the **"Rule"**) with request for comments regarding certain provisions of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (**"Dodd-Frank Act"**). Title II creates the Orderly Liquidation Authority (**"OLA"**), which is a mechanism under which "covered financial companies" can be liquidated in a uniform fashion rather than under inconsistent insolvency regimes. "Covered financial companies" are those whose failure pose a significant risk to the financial stability of the United States. The liquidation or rehabilitation of an insurance company that is a covered financial company will still be conducted under relevant state law, but a subsidiary or affiliate (including a parent company) that is not itself an insurance company will be subject to orderly liquidation under Title II of Dodd-Frank Act.

The interim rule contained two sections that were specific to insurance companies.

Insurance Company Subsidiaries

Under Section 380.5 of the Rule, if the FDIC acts as receiver for a direct or indirect subsidiary of an insurance company, and that subsidiary is not itself an insured depository institution or an insurance company, the distribution of the value obtained from the liquidation will be governed by Section 210(b)(1) of the Dodd-Frank Act, which sets the priorities under the OLA for expenses and unsecured claims. In addition, the Rule requires that the receiver distribute all proceeds due to the parent insurance company under the order of priority provisions of Section 210 (b)(1) of the Dodd-Frank Act to ensure that the liquidation value will be available to the policyholders of the parent insurance company to the extent required by applicable state laws and regulations.

Liens on Insurance Company Assets

Section 380.6 of the Rule tightens the language used to permit the FDIC to take liens on the assets of an insurance company and the assets of the covered subsidiaries of an insurance company. The FDIC may finance the orderly liquidation of covered financial companies and covered subsidiaries by the means it deems necessary, within its discretion, including by taking liens under Section 204(d)(4) of the Dodd-Frank Act. Section 380.6 of the Rule states that the FDIC will take liens only when (i) the lien is necessary for an orderly liquidation, and (ii) the taking of the lien will not impede the liquidation of the insurance company or the recovery by policyholders. This ensures that the FDIC will not take liens on insurance company assets or on affiliated company assets unless the FDIC deems the lien an essential aspect of funding the liquidation, and will not interfere with a rehabilitation or liquidation under state law.

The FDIC has requested submissions of written comments relating to the Rule. Comments are due no later than 28 March 2011.

David Alberts and John Drnek

Europe - Omnibus II: Directive proposal published by the European Commission

On 19 January 2011, the European Commission published a proposal in relation to the Omnibus II Directive together with a press release regarding the same.

The press release explains that, following the launch of the three new European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority (**"EIOPA"**), and the European Securities and Markets Authority) (the **"Authorities"**) on 1 January 2011, the Commission now proposes to make targeted changes to legislation in the areas of insurance and securities regulation to ensure that the new Authorities can work effectively. In particular, the proposal sets out in detail the scope for the Authorities to exercise their powers, which include the possibility to develop draft technical standards and to settle disagreements between national supervisors.

As far as Solvency II is concerned, the proposed Omnibus II Directive endeavours to ensure that EIOPA can work effectively, having taken over from the Committee of European Insurance and Occupational Pensions Supervisors (**"CEIOPS"**)[1].

The proposed Omnibus II Directive contains a limited set of amendments in relation to Solvency II, which include:

- further tasks for EIOPA such as harmonising technical approaches on the use of ratings in relation to the solvency capital requirements;
- extending the implementation date by two months (to 31 December 2012) to ensure better alignment with the end of the financial year of the majority of insurance and reinsurance undertakings; and
- enabling the European Commission to specify transitional measures in certain areas if deemed necessary to avoid market disruption and to allow a smooth transition to the new Solvency II regime.

Sarah Russell

1 As of 1 January 2011, the European Insurance and Occupational Pensions Authority (**"EIOPA"**) replaced CEIOPS.

US – Financial Stability Oversight Council meeting

The Dodd-Frank Act provided the Financial Stability Oversight Council (**"FSOC"**) with the authority to require federal supervision of certain non-bank financial companies and to impose prudential standards upon such firms if it is determined that the financial distress or the size, interconnectedness or activities of such firms pose a threat to the financial stability of the United States. On 18 January 2011, the FSOC met to discuss certain aspects of implementation of the Dodd-Frank Act.

Supervision and Regulation of Certain Nonbank Financial Companies

The FSOC published a proposed rule on 18 January 2011 identifying the framework that could be used to determine whether a non-bank financial company could pose a threat to the financial stability of the entire United States and implementing the process under which a firm would be considered for federal supervision and the imposition of prudential standards. A large insurer could be subject to this framework. The proposed framework for assessing systemic importance includes factors such as size, lack of substitutes for the financial services and products the company provides, interconnectedness with other financial firms, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny. This proposed rule has a 30-day public comment period that will close on 25 February 2011. It is expected that further action by FSOC on the final designation criteria and process will take place later this year.

The Volcker Rule

The Volcker Rule limits the proprietary trading and the investments in hedge funds and private equity funds of certain financial institutions that benefit from federal deposit insurance or the discount window of the Federal Reserve System. The Dodd-Frank Act generally exempts from the proprietary trading ban traditional investment activities of regulated insurance companies, subject to compliance with applicable state insurance laws. However, there are two types of insurance companies subject to the Volcker Rule, insurance companies that are affiliates of federally insured banks or thrifts and those that are subject to supervision by the Federal Reserve Board. On 18 January 2011, the FSOC released a study on the Volcker Rule that sets forth recommendations to identify and eliminate prohibited proprietary trading activities and prohibited investments in (or sponsorships of) hedge funds and private equity funds by banking entities. The study addresses proprietary trading by outlining criteria for defining prohibited trading activities, recommending indicia-based tests to identify permitted activities, and then identifying the grounds upon which certain high-risk activities could be prohibited. The study addresses investments or sponsorship of hedge funds and private equity funds by recommending certain substantive criteria to guide federal agencies in rulemaking and by recommending a framework for compliance and supervision.

Agencies have nine months after the completion of this study to adopt rules to implement the Volcker Rule. Agencies must consider the recommendations of the FSOC in drafting their regulations. Agencies must also communicate with one another to harmonize their respective regulations to ensure for level execution of Volcker Rule principles between parallel agencies.

David Alberts and John Drnek

UK - Solvency II: FSA provides additional information on level 3 measures pre-consultation process

On 17 January 2011, the FSA updated the part of its website related to Solvency II to comment on the level 3 pre-consultation process. The FSA notes that, given CEIOPS is not able to conduct a public consultation on proposals for level 3 text until after the level 2 implementing measures have been published by the European Commission, CEIOPS has agreed that it can conduct some pre-consultations.

The pre-consultation will only be provided to a small number of entities, including the European Insurance and Reinsurance Federation (**"CEA"**), CRO Forum, Amice and Groupe Consultatif. The pre-consultation on reporting and disclosure will also be sent to CFO Forum and the Fédération des Experts Comptables Européens.

Firms should get the level 3 pre-consultations from their trade bodies. For example, the Association of British Insurers will receive these from the CEA and plans to make them available to members. If an insurer is not a member of a trade body, it can also request the papers from its usual supervisory contact. The website states the following pre-consultations, which commenced in December 2010 and are currently open, will end on 11 February 2011:

- use test;
- calibration;
- profit and loss attribution; and
- validation.

It also notes that the following pre-consultations will end on 18 March 2011:

- system of governance; and
- guidelines on the own risk and solvency assessment.

Sarah Russell

US – New York Governor Andrew Cuomo proposes combined financial oversight agency

On 5 January 2011, Governor Andrew Cuomo of New York delivered his initial State of the State address, outlining his vision for New York in the upcoming years. During this speech, the Governor addressed the consumer protection and financial regulatory aspects of his plan to transform New York's economy. He stated that he intends to merge the state's banking and insurance departments in an effort to save taxpayer money and streamline regulation. The Governor indicated that he believed that the state's departments of banking, insurance, and consumer protection could all have done a better job of protecting consumers and regulating Wall Street. Governor Cuomo then went on to state that demarcations between banking and insurance do not exist in the marketplace, and that artificial boundaries between the departments are allowing certain activities to fall through the cracks in regulation.

New York will not be the first state to house multiple branches of financial regulation under one combined unit. For example, in Florida, the Financial Services Commission overseeing banking, securities and insurance was created by the Florida legislature in 2002. New Jersey's Department of Banking and Insurance is comprised of three main units including the Division of Banking, the Division of Insurance and the New Jersey Real Estate Commission. Roughly half of the 50 states have an insurance commission that is combined with another financial regulatory commission or have an insurance division that is incorporated into a broader financial oversight body comprised of smaller, parallel divisions.

Larry Hamilton

US – Changes to NY Credit for Reinsurance Regulations Now Effective

On 1 January 2011, the changes to New York's credit for reinsurance regulations took effect. The amendments (i) provide that New York's credit for reinsurance regulations will no longer apply to a non-New York ceding company if its domiciliary state is "an NAIC-accredited state, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk"; (ii) set forth certain prudent reinsurance credit risk management factors including diversification requirements; (iii) include provisions permitting the reduction of the trusteed surplus posted by alien assuming reinsurers under certain conditions; and (iv) most importantly, allow for reduced collateral requirements for credit for reinsurance obtained from unauthorized reinsurers. The amended regulations provide for 0%, 10%, 20%, 75% or 100% collateral requirements from unauthorized reinsurers using ratings-based criteria. The reduced collateral requirements, however, will not be available to reinsurers that have participated in solvent schemes or similar procedures involving U.S. ceding companies. Two leading reinsurers have already taken advantage of the new collateral scheme under New York law. For more detail, please see our prior article, *New York's Changes to Credit for Reinsurance Regulations and Special Treatment of Reinsurers Involved in Solvent Schemes of Arrangement*, from our December 2010 bulletin.

Vikram Sidhu

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