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Regulating Non-Bank SIFIs

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Agenda

- Regulatory powers over non-bank SIFIs
- Proposed principles for regulating non-bank SIFIs
- Applying principles to life insurance SIFIs
  - » Comparison of industry with banks
  - » Key regulatory issues
  - » Capital requirements
- Conclusions

Regulatory powers of the Fed

- Information requirements
- Supervisory dialogue
- Capital requirements
- Liquidity requirements
- Counterparty exposure limits
- Activity limits
- Fuller range of bank-like regulation and supervision

Proposed principles for regulation

- Carefully balance costs and benefits of regulation
- Focus primarily on *systemic* risk
- Defer to primary regulators, whenever appropriate
- Do not impose excessively bank-like regulation
- Avoid the dangers of a business “monoculture”
- Support useful innovation
- Try to minimize uncertainty about regulation
- Do not let these cautions deter action when systemic risks warrant concrete steps

Life insurers compared to banks

- Insurance is a pooling of risk; banking allocates funds to worthy projects and provides liquidity
- But, life insurers are also financial intermediaries and asset managers, as banks are
- Maturity of life insurance obligations is much longer than bank deposits and debt
  - » Gives life insurers more time to respond to trouble
  - » Creates need to own long-term assets
- Cost of insurance promises is variable, while bank liabilities are fixed

Some key regulatory issues

- What are the sources of systemic risk at insurers?
- What are the right capital requirements?
- What are the right liquidity requirements?
- How does the maturity structure of insurance liabilities affect the answers to these questions?
- Which accounting standards should be used?
- How should supervision be coordinated with state insurance regulators?

Capital requirements for insurers

- Fed is very familiar with bank capital requirements, which are aligned with Basel global accords
- Insurers are subject to state capital requirements coordinated through NAIC
- Fed will likely try to blend the two approaches
  - » It is comfortable with asset-based capital approach
  - » But, unlike NAIC, has little experience with capital requirements for liability risk and other risks
- A key question will be how maturity structure of insurance liabilities affects capital requirements

Conclusions

- It is critical that the Fed not regulate and supervise non-bank SIFIs as if they were just funny looking banks
- Some types of non-bank SIFIs are so much like banks, however, that the rules should be quite similar
- Life insurers are at the other end of the spectrum and it will be crucial to appropriately reflect the real differences with banking while still focusing on systemic risks that could arise
- Coordination with primary regulators will also be an issue, especially for life insurers
- As always, appropriately balancing costs and benefits of regulation will be very important