

Peer Review of the United States

Review Report

27 August 2013

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Foreword

Financial Stability Board (FSB) member jurisdictions have committed, under the FSB Charter and in the *FSB Framework for Strengthening Adherence to International Standards*,¹ to undergo periodic peer reviews. To fulfil this responsibility, the FSB has established a regular programme of country and thematic peer reviews of its member jurisdictions.

Country reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies agreed within the FSB, as well as their effectiveness in achieving desired outcomes. They examine the steps taken or planned by national authorities to address International Monetary Fund-World Bank Financial Sector Assessment Program (FSAP) and Report on the Observance of Standards and Codes (ROSC) recommendations on financial regulation and supervision as well as on institutional and market infrastructure that are deemed most important and relevant to the FSB's core mandate of promoting financial stability. Country reviews can also focus on regulatory, supervisory or other financial sector policy issues not covered in the FSAP that are timely and topical for the jurisdiction itself and for the broader FSB membership. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, or its compliance with international financial standards.

FSB jurisdictions have committed to undergo an FSAP assessment every 5 years; peer reviews taking place 2-3 years following an FSAP will complement that cycle. As part of this commitment, the United States (US) volunteered to undertake a country peer review in 2013.

This report describes the findings and conclusions of the US peer review, including the key elements of the discussion in the FSB's Standing Committee on Standards Implementation (SCSI) on 15 July 2013. It is the eighth country peer review conducted by the FSB and the second using the revised objectives and guidelines for the conduct of peer reviews set forth in the December 2011 *Handbook for FSB Peer Reviews*.²

The analysis and conclusions of this peer review are based on the US financial authorities' responses to a questionnaire and reflect information on the progress of relevant reforms as of July 2013. The review has also benefited from dialogue with the US authorities as well as discussion in the FSB SCSI.

The draft report for discussion was prepared by a team chaired by Andreas Dombret (Deutsche Bundesbank) and comprising Daniel Heller (Swiss National Bank), Jutaro Kaneko (Japan Financial Services Agency), Charlotte Paterson (European Commission), Carmelo Salleo (European Systemic Risk Board Secretariat), Lawrence Schembri (Bank of Canada), Mamta Suri, (Insurance Regulatory and Development Authority of India). Mark Chambers, Simonetta Iannotti, Tarun Singh and Costas Stephanou (FSB Secretariat) provided support to the team and contributed to the preparation of the peer review report.

¹ See http://www.financialstabilityboard.org/publications/r_100109a.pdf.

² See http://www.financialstabilityboard.org/publications/r_120201.pdf.

Abbreviations

BHC	Bank Holding Company
CCAR	Comprehensive Capital Analysis and Review
CCP	Central Counterparty
CFPB	Consumer Financial Protection Bureau
CFTC	Commodity Futures Trading Commission
CPSS	Committee on Payment and Settlement Systems
CSD	Central securities depository
DCO	Derivatives clearing organisation
DFA	Dodd-Frank Wall Street Reform and Consumer Protection Act
DFMU	Designated Financial Market Utility
DIF	Deposit Insurance Fund
FACI	Federal Advisory Committee on Insurance
FBIIC	Financial and Banking Information Infrastructure Committee
FBO	Foreign banking organisation
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
Fed	Federal Reserve Board
FHFA	Federal Housing Finance Agency
FIO	Federal Insurance Office
FINRA	Financial Industry Regulatory Authority
FMI	Financial Market Infrastructure
FMU	Financial Market Utility
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
GAO	General Accounting Office
GDP	Gross Domestic Product
GSE	Government-sponsored enterprise
IAIG	International Active Insurance Group
ICPs	Insurance Core Principles
IHC	Insurance holding company
IOSCO	International Organization of Securities Commissions
LEI	Legal entity identifier
LISCC	Large Institution Supervision Coordinating Committee
MBS	Mortgage-backed security
MMF	Money market mutual fund
MSP	Major swap participant
MSSP	Major security-based swap participant
MoU	Memorandum of Understanding
NAIC	National Association of Insurance Commissioners
NAV	Net asset value
NMDOI	New Mexico Department of Insurance
NMS	National market system
NPR	Notice of proposed rulemaking
OCC	Office of the Comptroller of the Currency
OFR	Office of Financial Research
OLA	Orderly Liquidation Authority

OMO	Open market operations
ORSA	Own Risk Self-Assessment (NAIC Model Law)
OTC	Over-the-Counter
OTS	Office of Thrift Supervision
PBR	Principle-based reserving
PFMIs	Principles for Financial Market Infrastructures
PWG	President's Working Group on Financial Markets
RBC	Risk-based capital
ROSC	Reports on the Observance of Standards and Codes
SBSD	Security-based swap dealer
SEC	Securities and Exchange Commission
SD	Swap dealer
SIDCOs	Systemically important derivatives clearing organisations
SIFI	Systemically important financial institution
SLHCs	Savings and loan holding companies
STIFs	Short-term investment funds
TR	Trade repository
US	United States
USD	United States Dollar

Executive summary

Background and objectives

The main purpose of this peer review is to examine three topics that are relevant for financial stability and important for the United States (US): systemic risk oversight arrangements; supervision and oversight of financial market infrastructures (FMIs); and insurance supervision. All three topics were included in the key Financial Sector Assessment Program (FSAP) recommendations and are topical for the broader FSB membership.

Main findings

Good progress has been made by the US authorities in following up on the FSAP recommendations, particularly as regards systemic risk oversight arrangements and the supervision and oversight of FMIs. A unifying theme behind all three topics is the complex and fragmented US regulatory and supervisory structure, characterised by multiple agencies at the state and federal levels with closely related (and sometimes overlapping) responsibilities. To a large extent, the reforms analysed in this peer review focus on the need to ensure effective and efficient coordination and information sharing arrangements and to address any overlaps or gaps in the roles and responsibilities of the respective agencies.

Systemic risk oversight arrangements

Following the FSAP, the US Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA). The DFA, which was signed into federal law in July 2010, is a comprehensive set of reforms to the US financial regulatory and supervisory system in response to the lessons from the financial crisis. The DFA addressed the systemic risk oversight gap in the regulatory framework by creating the Financial Stability Oversight Council (FSOC) and by making it directly accountable to the US Congress. To support the activities of the FSOC and its member agencies, the DFA also created the Office of Financial Research (OFR) within the Treasury Department.

With the establishment of the FSOC and its key powers under the DFA, the US has taken an important step to establish systemic oversight arrangements. Given the structure of the US system of financial regulation and supervision, the FSOC represents a reasonable approach to coordinated macroprudential oversight. Despite only being established in 2010, the FSOC has made good progress in addressing the FSAP recommendations. In particular, it has provided a useful forum for facilitating coordination and the exchange of information by various member agencies to move towards a common approach to assessing and mitigating systemic risks. The FSOC has already designated eight financial market infrastructures (FMIs, known as financial market utilities or FMUs in the US) and two non-bank financial companies as systemically important. Designated institutions are subject to enhanced regulation and supervision by the Federal Reserve Board (Fed). As these reforms are ongoing, it is too early to evaluate the overall effectiveness of the FSOC; its size and complex mandate imply that it may take some time for it to reach an operating steady state.

The OFR is an important innovation for the purpose of supporting the FSOC's work. It represents a critical component of an effective macroprudential framework because its

activities – independent data and tool development and research from a system-wide perspective – will enhance the understanding, measurement and assessment of systemic risks and thereby strengthen the ability to address them. In attempting to achieve these ambitious goals, the OFR will need to identify the “blind spots” in the regulatory landscape and to design effective information collections to measure risks to financial stability.

Given its broad and diverse membership, the FSOC’s decisions and actions reflect the views of a wide range of agencies with different mandates and interests. This might affect in some cases the FSOC’s ability to take decisions in an effective and prompt manner, as the desire to reach a reasonable consensus among a large group of authorities might come at the expense of delivering clear and timely messages. A significant consideration in this respect is that the DFA did not, in general, alter the regulatory authorities and powers of the FSOC’s member agencies when establishing the FSOC. Thus, the FSOC can make recommendations for heightened prudential regulatory standards in areas within the purview of a member agency, but can only impose them in limited situations. The member agency must respond publicly to final recommendations made by the FSOC on a “comply or explain” basis.

Despite the good progress made to date on systemic oversight arrangements, some issues may warrant further consideration to enhance the effectiveness of the FSOC. These are:

- Coordinating role of FSOC – More clarity is needed on the specification of the macroprudential framework and on the related processes to operationalise it, including: the role played by the OFR and the division of labour with member agencies; the process that the FSOC would follow to decide on the use of microprudential instruments “owned” by member agencies for macroprudential purposes; and the FSOC’s role in reviewing proposed regulations prepared by its member agencies to ensure consistency of treatment and minimise the scope for regulatory arbitrage, thereby promoting financial stability.
- Systemic risk identification and analysis – While the risks or threats to financial stability are already identified in FSOC annual reports, those risks are not analysed in detail and are not prioritised in terms of their significance or their immediacy. Furthermore, the scope of the risk analysis currently is relatively narrow as it tends to reflect the sectoral perspectives of individual member agencies, rather than providing a system-wide view of interconnections and exposures to risks. Enhancements to the FSOC’s risk assessment framework can usefully address these issues.
- Role of the OFR – Being a newcomer in a crowded field of US regulatory and supervisory agencies, the OFR needs to carve out its role. For the FSOC to transform itself into an effective macroprudential body that is greater than the sum of its parts, the OFR will need to coordinate and contribute to the work of member agencies so as to provide a system-wide perspective of risks grounded in rigorous, fact-based analysis. In order to do that, however, the OFR needs support from FSOC member agencies to be able to collect data to fill identified gaps; sufficient and secure access to key relevant data already collected by agencies; and, appropriate financial and human resources to push the frontier of financial stability research and analysis.
- Communication – The FSOC’s communication to date, which takes place primarily via its annual report, is focused on addressing its accountability function to Congress and the general public. A key component of communication could be the set of FSOC

recommendations to help promote financial stability, but these will need to be analysed in more detail, be prioritised or grouped by type, and their follow up be monitored and reported accordingly. A more targeted communication strategy with multiple outlets would ensure more focused messages delivered more effectively to their intended audiences, which may differ depending on the medium.

Supervision and oversight of FMIs

Substantial progress has been made by the US authorities to strengthen the oversight and supervision of systemically important FMIs, including by addressing the relevant FSAP recommendations. In particular, there is strong evidence of increased supervisory coordination among the Fed, the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC); the Fed has been given an expanded role in the oversight and supervision of all FMUs designated as systemically important (DFMUs); there is ongoing rulemaking by the relevant agencies on enhanced prudential and oversight arrangements for DFMUs to align them with international guidance; and there is ongoing work by the Fed to define the terms of access by DFMUs to its account services.

Each of the eight DFMUs has a primary US supervisor, and the overall framework for supervisory coordination among the agencies is well anchored in Title VIII of DFA. As experience is gained with this process, it would be useful to review the effectiveness and efficiency of existing coordination mechanisms and to consider whether additional measures may be necessary. Such measures could include the secondment of staff across agencies and the introduction of arrangements that cover broader supervisory cooperation and not only the exchange of confidential information.

With respect to the FSAP recommendation concerning settlement in central bank money, the DFA authorises the Fed to provide deposit accounts to DFMUs, although it does not oblige it to provide such accounts. The Fed intends to finalise its rules on DFMUs' account policy following the public consultation. Once this process is completed, the relevant US agencies may want to consider encouraging DFMUs to investigate the possibility of opening a Fed account in order to use central bank money to make settlements, in accordance with Principle 9 of the CPSS-IOSCO *Principles for Financial Market Infrastructures* (PFMIs).

A few issues remain pending or may need to be considered as the US authorities continue to enhance the supervision and oversight framework for FMIs. These revolve around:

- Cross-border supervisory cooperation – As in the case of domestic supervisory cooperation, continuing efforts to enhance consultation, cooperation and information sharing at the international level would promote the safety and efficiency of cross-border or multicurrency FMIs. This is particularly relevant given the growing global importance of US-based FMIs and the increasing reliance of some US-based market participants on FMIs in other jurisdictions. In this regard, US agencies should further strengthen supervisory consultation, cooperation and information sharing with foreign regulators, consistent with existing international guidance, in order to reduce the probability of gaps in regulation, supervision, and oversight and to minimise the potential duplication of effort and the burden on the FMIs or the cooperating authorities. This may include, where appropriate, the establishment of additional cooperative oversight arrangements, adoption of MoUs and information sharing protocols, and consultation and coordination over on-site visits of supervised FMIs.

- Implementation of the PFMI – As members of CPSS or IOSCO, the Fed, SEC and CFTC are committed to adoption of the PFMI as the international standard for the regulation and oversight of systemically important FMI. Currently, all three agencies are in the process of adopting the PFMI into their respective regulatory frameworks. Given the global importance of the US financial system, the pace of implementation of these rules can create spillovers for internationally active US firms as well as for foreign firms and jurisdictions. It will therefore be critical to ensure the speedy completion of rulemaking on enhanced prudential requirements, including by providing greater clarity to market participants on the indicative timelines for completing this process (while acknowledging that those timelines may need to be revised in the future).
- Contingency planning – The framework for the provision of emergency liquidity by the Fed is outlined in the DFA, but there are no prescribed Fed regulations concerning the maximum amount or eligible collateral for emergency lending to DFMUs. Careful consideration needs to be given to the fact that liquidity needs for DFMUs, particularly for central counterparties (CCPs), may fluctuate greatly and quickly during a settlement day; in extreme circumstances, emergency liquidity facilities may need to be considered. Private sector liquidity should constitute the first line of defense for CCPs against liquidity shortfalls. Ensuring that DFMUs fully implement enhanced prudential requirements for credit and liquidity risks, and that liquidity risks are addressed in overall contingency planning, is critical in this regard.

Insurance supervision

The US federal and state authorities have begun to address the insurance-related FSAP recommendations. In particular, Congress established the FIO under the DFA (albeit not with the explicit legal authority to promote greater regulatory uniformity in the insurance sector), while the FSOC recently designated one insurance company as systemically important and therefore subject to consolidated supervision and enhanced prudential standards by the Fed. Information sharing and coordination between state regulators and federal authorities has increased. In addition, state authorities have taken useful steps to improve insurance group supervision; to modernise solvency requirements; and to improve disclosures required for securities lending operations by insurance companies.

In spite of these accomplishments, however, significant additional work is required to fully address the FSAP recommendations, particularly in terms of:

- Regulatory uniformity – A forthcoming report by the FIO to Congress and the President will set forth how to modernise and improve the system of insurance regulation in the US and, among other factors, will consider the degree of national uniformity of state insurance regulation. While the National Association of Insurance Commissioners (NAIC) plays an important role in promoting consistency between states, the fact that it is not a supervisory authority and that state laws must only be “substantially similar” to the NAIC’s model laws allows for divergent approaches, which may impact the consistency of supervision applied to large insurance groups with national and international reach. The architecture for insurance supervision in the US, characterised by the multiplicity of state regulations, the absence of federal regulatory powers to promote greater regulatory uniformity and the limited rights to pre-empt

state law, constrains the ability of the US to ensure regulatory uniformity in the insurance sector. While the FIO represents the US on international insurance matters and negotiates covered agreements, only the states have the authority (but are under no legal obligation) to implement laws that are consistent with those agreements and international standards agreed within the IAIS. Given the drawbacks of the current regulatory set-up, the US authorities should carefully consider and provide recommendations to Congress as to whether migration towards a more federal and streamlined structure may be a more effective means of achieving greater regulatory uniformity. Moreover, the FIO's current human resources may need to be augmented to fully address the tasks that it has been mandated under DFA. The FIO should also enhance its monitoring of the insurance sector through greater use of non-public information that it is able to access, and be given more resources and powers to be able to address issues and gaps that it identifies.

- Enhanced insurance group supervision – State insurance regulators have taken some positive steps to develop the supervision of insurance groups through the NAIC's changes to its Insurance Holding Company Models. Thus far, however, only 15 states have adopted the revised models. In order to be effective, the NAIC will need to make these revisions mandatory for accreditation and the remaining states that have yet to change their laws will need to enact these models. Moreover, the FSAP recommendation for consolidated financial reporting requires additional steps to be taken by US authorities. Group-wide consolidated data and the financial statements of affiliates within an insurance group are not systematically collected and data is usually only requested by regulators in those instances where it has been produced for other mandated purposes. This constrains the ability of the state authorities to effectively supervise all insurance groups and to analyse events that might impact the group as a whole, absent a framework for consolidated regulation and supervision. Moreover, no additional powers have been conferred on state regulators with respect to holding companies, forcing them to rely on achieving outcomes indirectly via the regulated entities of a holding company. Finally, no action has yet been taken in relation to the FSAP recommendation to use quantitative techniques and practices or to apply insurance capital requirements to the consolidated insurance group.
- Modernisation of solvency requirements – As principles-based reserving (PBR) is enacted by the states, the NAIC and state regulators will need strong actuarial expertise and regulatory tools to deal with the complexities of a less formulaic framework. Further work is needed to revise capital requirements in light of PBR and to evaluate the appropriateness of the capital treatment of market risks associated with life insurance products. The absence of a target safety level of reserving and an associated target safety level for capital makes it difficult to make peer comparisons across insurers and against other international insurance regimes, although NAIC is of the view that an overall target safety level is unachievable and unnecessary. The safety level targets for individual risks are in most cases not set out in NAIC models.
- Governance and funding reforms – While the vesting of regulatory powers in the State Insurance Commissioner in principle ensures that departments are operationally independent, the ability of the governor in most states to dismiss Commissioners at any time, and without a public statement of reasons, continues to expose departments

to potential political influences. The NAIC and state regulators are of the view that the funding and staffing of state regulators is sufficient and that no further reforms are necessary at this time. However, the need to bolster specialist skills will significantly increase following the introduction of new regulatory standards such as PBR.

Recommendations

In response to the aforementioned findings and issues, the peer review has identified the following recommendations for consideration by the US federal and state authorities:

Systemic risk oversight arrangements

- The FSOC should develop a more systematic, analytical and transparent macroprudential framework for coordinating the efforts and incorporating the bottom-up views of member agencies and the OFR to address systemic risk. This includes ensuring that microprudential policies by member agencies are coherent and consistent with the overall goal of promoting financial stability.
- The FSOC should develop a more in-depth and holistic analysis of the systemic risks to financial stability. These risks should be prioritised, tracked over time, and separated between shorter-term conjunctural versus longer-term structural vulnerabilities. Risk identification and prioritisation should take place within a rigorous and transparent framework based on clearly defined criteria and the expert judgment of FSOC members. The recommendations to mitigate risks should be more specific as to the adopted mitigation actions, and should be monitored to assess their remedial impact.
- The OFR's role in supporting the FSOC's activities should be further enhanced. The OFR should play a coordinating role in the monitoring and assessment of financial system developments as well as in the evaluation of policy effectiveness by leveraging its analytical strengths, its access to data and leading-edge research, and its system-wide perspective.
- The FSOC should undertake an assessment of the various target audiences for its public communication, and revise (and potentially expand) the range and adjust the content of its publications accordingly.

Supervision and oversight of FMIs

- The US agencies should continue to enhance cooperation with foreign regulators with respect to US-based and relevant foreign FMIs, in line with international guidance.
- The US agencies should consider publishing an indicative timeline for the implementation of PFMIs to enhance regulatory transparency.
- The US agencies should continue to strengthen liquidity risk management for DFMUs through implementation of appropriate standards, supervisory processes as well as liquidity contingency planning and testing.

Insurance supervision

- The US authorities should promote greater regulatory uniformity in the insurance sector, including by conferring additional powers and resources at the federal level where necessary. The FIO should enhance its monitoring of the sector through

increased use of non-public information, and be further strengthened to be able to take action to address issues and gaps identified.

- The US authorities should further enhance insurance group supervision by introducing requirements for consolidated financial reporting for all insurance groups. Lead supervisors should be given additional powers to fully assess the financial condition of the entire insurance group, such as having direct powers over holding companies.
- State authorities should continue to modernise solvency requirements through enacting PBR into state law and the NAIC should take measures to clarify the safety level targets for individual risks and the overall effect of reserving and capital requirements in its model laws.
- State authorities should implement the FSAP recommendation concerning the terms of state Commissioners' appointments, the rulemaking powers of state insurance departments, and their funding and staffing to bolster specialist skills.

1. Introduction

The United States (US) underwent an assessment under the Financial Sector Assessment Program (FSAP) in 2010.³ The FSAP included assessments⁴ of the *Basel Core Principles for Effective Banking Supervision*, the International Association of Insurance Supervisors (IAIS) *Insurance Core Principles (ICPs)*, the International Organisation of Securities Commissions (IOSCO) *Principles and Objectives of Securities Regulation*, and the Committee on Payment and Settlement Systems (CPSS)-IOSCO *Recommendations for Central Counterparties and Recommendations for Securities Settlement Systems*.

The FSAP concluded that the authorities' forceful response to the financial crisis had rolled back systemic market pressures, but that the cost of intervention had been high and that stability remained tenuous. It noted the comprehensive reforms being legislated to address many issues that had left the system vulnerable and stressed the need to ensure effective implementation. It recommended strengthening micro-prudential regulation and supervision, and establishing clear macro-prudential responsibilities; bolstering market discipline; and continuing US leadership in building an international consensus on financial reforms.

The main purpose of the peer review report is to examine three topics that are relevant for financial stability and important for the US: systemic risk oversight arrangements; supervision and oversight of financial market infrastructures (FMIs); and insurance supervision. All three topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken to date by the US authorities to implement reforms in these areas, including by following up on relevant FSAP and ROSC recommendations. In particular, the review evaluates progress with the reforms in order to draw conclusions and policy implications as well as identify remaining impediments and lessons of experience that could be of benefit to the US and its FSB peers.

The report has three main sections, corresponding to the three topics being reviewed. Section 2 focuses on the institutional and operational set-up of the Financial Stability Oversight Council (FSOC) and takes stock of progress in operationalizing its mandate. Section 3 (and Annex 2) describes the steps taken by the US authorities in strengthening the supervision and oversight of FMIs (known as financial market utilities, or FMUs, in the US). Section 4 analyses the steps taken by the US federal and state authorities to follow up on FSAP recommendations to improve insurance supervision.

In addition to these sections, Annex 1 provides background information on the structure of the US financial system and on other recent regulatory developments, while Annex 3 presents the follow-up actions reported by the US authorities to other key FSAP recommendations; these actions have not been analysed as part of the FSB peer review and are presented solely for purposes of transparency and completeness.

³ See "United States: Financial System Stability Assessment" (IMF Country Report No. 10/247, July 2010, available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10247.pdf>).

⁴ See "United States: Reports on Observance and Codes" (IMF Country Report No. 10/250, July 2010, available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10250.pdf>). All ROSC assessments and technical notes have been published and are available on the IMF website (<http://www.imf.org/external/np/fsap/fsap.aspx>).

2. Systemic risk oversight arrangements

Background

One of the key weaknesses that contributed to the financial crisis in the US was the lack of a mechanism to coordinate the efforts of various US regulatory and supervisory agencies and take responsibility for monitoring and mitigating systemic risk to protect the overall stability of the US financial system. In response, the FSAP made three key recommendations to institutionalise and strengthen systemic risk oversight:

- Establish a council of the regulatory agencies, the Federal Reserve Board (Fed), and the US Treasury, with a mandate for financial stability and powers *inter alia* to designate potentially systemic firms for enhanced regulation and supervision focused on systemic risk.
- Define the Fed as the lead executor of this council and the consolidated supervisor of designated potentially systemic financial firms, to work with other regulators.
- Provide the Fed with oversight authority over systemically important payment, clearing and settlement infrastructure.

This section focuses on the institutional and operational arrangements of the FSOC, takes stock of progress in operationalizing its mandate, and seeks to identify remaining challenges.

Establishment of the FSOC

Following the FSAP, the US authorities established the FSOC under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act (DFA), which was signed into federal law in July 2010, is a comprehensive set of reforms to the US financial regulatory and supervisory system in response to the lessons from the financial crisis. The DFA addressed the systemic risk oversight gap in the regulatory framework by creating the FSOC – the first federal entity vested with clear responsibility for maintaining financial stability – and by making it directly accountable to the US Congress.

The FSOC consists of 10 voting and 5 non-voting members, and it includes all of the major federal regulatory and supervisory agencies for financial institutions and markets as well as representatives from state financial authorities.⁵ It is chaired by the US Treasury Secretary and operates on a majority voting basis, although every effort is made to reach consensus among the voting members.⁶ The FSOC's three statutory missions under the DFA are to identify risks to the financial stability of the US; to promote market discipline; and to respond to emerging threats to the stability of the US financial system.

To achieve these objectives the FSOC is authorised to perform the following functions:

⁵ The 10 voting members are the Secretary of the Treasury (Chair), Chair of the Federal Reserve Board, Comptroller of the Currency (OCC), Director of the Consumer Financial Protection Bureau (CFPB), Chair of the US Securities and Exchange Commission (SEC), Chair of the Federal Deposit Insurance Corporation (FDIC), Chair of the Commodity Futures Trading Commission (CFTC), Director of the Federal Housing Finance Authority (FHFA), Chair of the National Credit Union Association, and an independent member (with insurance expertise) appointed by the President.

⁶ For the purpose of designating systemically important non-bank financial companies and financial market utilities, a two-thirds majority vote is required, which must include the Chair in the majority.

- Facilitate coordination and the exchange of information, data and analysis among regulatory and supervisory agencies, in particular to eliminate gaps in the regulatory structure;
- Designate systemically important nonbank financial companies and FMUs for more intense regulatory oversight and supervision by the Fed⁷; and
- Make recommendations to member agencies, under section 120 of the DFA, for heightened regulatory standards and structure of systemically important financial institutions (SIFIs).

To support the activities of the FSOC and its member agencies, the DFA also created the Office of Financial Research (OFR) within the Treasury Department, to collect and improve the quality of financial data, develop tools to evaluate risks to the financial system and perform applied and necessary long-term research.⁸ The OFR currently has a staff of around 160 employees, and it projects steady-state staffing levels of 275-300 by fiscal year 2014-15.

The FSOC and OFR meet frequently at the working level to coordinate their efforts and minimize any overlap.⁹ The FSOC is also supported by several standing committees, including the committees of Deputies, Systemic Risk (Institutions and Markets sub-committees), Designations of Nonbank Financial Companies, Designations of Financial Market Utilities, Heightened Prudential Standards, and Data. These committees may meet more frequently than the FSOC and include senior representation from the member agencies and the OFR. They are pre-decisional and deliberative in nature and currently operate by consensus.¹⁰ The FSOC and the OFR have broad authority under the DFA to obtain data and other information from member agencies and firms to support the work of the FSOC, subject to confidentiality requirements and to coordinated efforts to reduce reporting burden on private sector firms.¹¹

Since October 2010, the FSOC has held over 30 meetings, on an approximately monthly basis, for which minutes are published and webcasts are available on the FSOC website. Based on its published transparency policy,¹² sessions that discuss individual institutions or other market-sensitive information are not publicly disclosed. In addition to the minutes from the FSOC meetings, the key communications vehicles are the annual report, public

⁷ Section 165 of the DFA assigns responsibility to the Fed for overseeing large interconnected bank holding companies and developing enhanced prudential standards for them.

⁸ The Treasury also houses a small secretariat of 22 employees to support the FSOC and its committees by providing advice on statutory authorities and obligations, drafting reports to Congress, and managing its document flow and public disclosure. The expenses of the secretariat for the first two years were covered by the Fed and, as is the case with the OFR, will subsequently be covered by assessments on bank holding companies with total consolidated assets of US\$50 billion or greater and on nonbank financial companies designated by the FSOC and overseen by the Fed.

⁹ The OFR publishes an annual report that focuses on financial data development, including standards and gaps, and systemic risk analysis and research. The 2012 annual report can be found at http://www.treasury.gov/initiatives/wsr/ofr/Documents/OFR_Annual_Report_071912_Final.pdf.

¹⁰ A list of the FSOC's committees with a summary description of their mandates can be found at <http://www.treasury.gov/initiatives/Documents/X%20-%20Committee%20Structure%20111910.pdf>

¹¹ Under the DFA, the OFR has subpoena powers to obtain the required information from firms.

¹² See <http://www.treasury.gov/initiatives/Documents/FSOCtransparencypolicy.pdf>.

announcements, studies and reports (often requested by Congress), and the website.¹³ The FSOC annual report, signed by all voting members, is seen as the primary accountability document to Congress; to date, three reports have been published (2011, 2012 and 2013). The annual report reviews significant financial market and regulatory developments, with a focus on assessing potential emerging threats to financial stability and, where possible, makes recommendations to mitigate these threats. The report also includes recommendations for heightened risk management and supervision and to advance progress on financial reform.¹⁴

A significant consideration in the operation of the FSOC is that the DFA did not, in general, alter the regulatory authorities and powers of its member agencies when establishing the FSOC. Thus, the FSOC can make recommendations for heightened prudential regulatory standards in areas within the purview of a member agency, but can only impose them in limited situations.¹⁵ The member agency must respond publicly to final recommendations made by the FSOC on a “comply or explain” basis. A notable recent example of this power is the proposed set of recommendations to the SEC to reduce the probability of runs at money market funds, which was issued by the FSOC in November 2012 (see Box 1).¹⁶ Another important implication is that, although member agencies are encouraged to use the FSOC to coordinate and consult on their own regulatory initiatives, they are not obliged to incorporate the feedback they receive from the FSOC in finalizing their rules and regulations.¹⁷

Designation of Systemically Important Financial Institutions and FMUs: Different sections of the DFA specify the process and criteria for designating systemically important nonbank financial companies and FMUs. The DFA also describes the types of enhanced prudential standards to which these entities and systemically important bank holding companies should comply and it stipulates that all such SIFIs are subject to more intense consolidated supervision by the Fed.

Under Section 113 of the DFA, the FSOC is authorised to determine that a nonbank financial company will be supervised by the Fed and be subject to prudential standards if the FSOC determines that (1) material financial distress at the nonbank financial company or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company, could pose a threat to US financial stability.¹⁸ The process to

¹³ See <http://www.treasury.gov/initiatives/fsoc/Pages/home.aspx> for more details.

¹⁴ The FSOC has developed a series of recommendations in its annual reports highlighting the need for additional reforms to address vulnerabilities in the US financial system, including reforms to money market mutual funds, tri-party repo markets, and the US housing finance system.

¹⁵ In particular, the FSOC can impose such standards for FMUs under §805(a)(2) of the DFA (“Upon an affirmative vote by not fewer than 2/3 of the members then serving on the Council, the Council ...[may require either the CFTC or the SEC] to prescribe such risk management standards as the Council determines is necessary to address the specific prudential requirements that are determined to be insufficient.”).

¹⁶ See <http://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform.pdf>.

¹⁷ Under Section 119 of the DFA, the FSOC has the power to make a recommendation to resolve a jurisdictional dispute among member agencies at the request of the one of the agencies involved. To date, this dispute resolution authority has not been used.

¹⁸ The DFA allows for the designation of both domestic and foreign-headquartered nonbank financial companies. In the context of a foreign- headquartered nonbank financial company, the DFA stipulates that the FSOC should consult with the appropriate home country supervisor when the firm is under consideration.

designate nonbank financial companies – including insurance companies, swap dealers, commodity brokers, financial companies, money market and other types of investment funds – for supervision by the Fed is underway, and it involves the development of models and collection of necessary data to assess systemic importance. The FSOC issued rules on the processes for designating FMUs and nonbank financial companies in July 2011 and April 2012 respectively. The FSOC designated eight FMUs as systemically important under Title VIII of the DFA in July 2012 (see section 3), while it also designated two non-bank financial companies (including one insurance company; see section 4) in July 2013. Under the DFA, nonbank financial companies subject to a proposed designation by the FSOC have 30 days to ask for a hearing, after which the Council will take its final decision on the designation.¹⁹

Under Section 165 of the DFA, “large interconnected” bank holding companies (BHCs) with total consolidated assets equal to or greater than US\$50 billion are subject to enhanced prudential standards. The DFA also stipulates that the Fed is responsible for developing these standards and ensuring their implementation for all BHCs that meet or exceed this size threshold.

The DFA gives the Fed authority to take the lead in overseeing and regulating all SIFIs operating in the US. This authority, combined with that for systemically important FMUs, gives the Fed a predominant role in executing measures to oversee and control the risks undertaken by major financial institutions. In December 2011, the Fed released a proposed rule for heightened regulatory standards that would apply to all large interconnected US BHCs and to all designated nonbank financial companies. These institutions would be subject to specific regulatory requirements for capital, liquidity, credit exposure, stress-testing, risk management and early remediation.²⁰

¹⁹ See <http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx>. After a final designation determination has been made, a company has a right to judicial review.

²⁰ In December 2012, the Fed also published heightened regulatory standards for foreign banking organizations (FBOs) operating in the US. See <http://www.gpo.gov/fdsys/pkg/FR-2012-01-05/pdf/2011-33364.pdf> and <http://www.gpo.gov/fdsys/pkg/FR-2012-12-28/pdf/2012-30734.pdf>.

Box 1: The FSOC at work – Proposed recommendations on MMF reform

Background

Money market mutual funds (MMFs) are a significant source of short-term funding for businesses, financial institutions, and governments. However, the financial crisis demonstrated that MMFs are susceptible to runs that can have destabilizing implications for financial markets and the economy. The US Treasury Department's guarantee of more than USD 3 trillion of MMF shares and a series of liquidity programs introduced by the Fed were needed to help stop the run on MMFs during the crisis. The vulnerabilities of MMFs arise from a combination of factors, including their maintenance of a stable value per share. This creates a "first-mover advantage" that provides an incentive for investors to redeem their shares at the first indication of any perceived threat to an MMF's value or liquidity.

The FSOC's proposal

The broader financial regulatory community has focused substantial attention on MMFs and the risks they pose. In the US, both the President's Working Group on Financial Markets (PWG) in 2010 and the FSOC (via unanimous recommendations in its 2011 and 2012 annual reports) called for additional reforms to address the structural vulnerabilities in MMFs.

In the international domain, the International Organization of Securities Commissions (IOSCO) published a set of policy recommendations for MMFs in October 2012.²¹ The issue has also drawn concerns in Europe, where the European Systemic Risk Board issued a Recommendation on MMFs in December 2012 centred on the need to move to a variable Net Asset Value (NAV). In order to encourage decisive action by the SEC, in November 2012 the FSOC published a formal set of proposed recommendations that offer three alternatives for consideration: i) a floating NAV; ii) a stable NAV with a NAV buffer and "minimum balance at risk"; and iii) a stable NAV with NAV buffer and other measures.²² These proposals are not mutually exclusive.

Process

The FSOC consulted with SEC staff; in addition, the proposed standards and safeguards take into account costs to long-term economic growth as per Section 120 of the DFA. After a 60-day public comment period on the proposed recommendations, which ended in February 2013, the FSOC may issue a final recommendation to the SEC that, pursuant to the DFA, would be required to impose the recommended standards (or similar standards that the Council deems acceptable) or explain in writing to the Council within 90 days why it has determined not to follow the recommendation.

Current status

The SEC issued proposed rules in June to reduce the systemic impact of MMFs.²³ The SEC proposal includes two principal alternative reforms that could be adopted alone or in combination as well as additional diversification and disclosure measures that would apply under either alternative. The public comment period for the proposal will last for 90 days after its publication in the Federal Register, and the SEC will take into account the comments received when drafting any final set of rules.

²¹ See <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD392.pdf>.

²² See <http://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Proposed%20Recommendations%20Regarding%20Money%20Market%20Mutual%20Fund%20Reform.pdf>

²³ See <http://www.sec.gov/rules/proposed/2013/33-9408.pdf>.

Lessons learned and issues going forward

Overall progress: With the establishment of the FSOC and its key powers under the DFA, the US has taken an important step to establish systemic oversight arrangements. Given the complex structure of the US system of financial regulation and supervision, characterised by multiple agencies at the state and federal levels with closely related (and sometimes overlapping) responsibilities, the FSOC represents a reasonable approach to coordinated macroprudential oversight. Despite only being established in 2010, the FSOC has made good progress in addressing the FSAP recommendations. In particular, it has provided a useful forum for facilitating coordination and the exchange of information by various member agencies to move towards a common approach to assessing and mitigating systemic risks; and it has already operationalised the designation of systemically important non-bank financial companies and FMUs. Participation in the FSOC is particularly important for those agencies that, heretofore, had not been engaged in systemic risk analysis or had not considered risks at system-wide level. As these reforms are ongoing, it is too early to evaluate the overall effectiveness of the FSOC; its size and complex mandate imply that it may take some time for it to reach an operating steady state.²⁴

A notable action to date has been the release of a proposed set of recommendations on regulatory options to the SEC for strengthening the regulation of MMFs, consistent with the October 2012 IOSCO recommendations. The process of issuing recommendations to member agencies represents a useful way to address structural vulnerabilities, but it might be too cumbersome should the FSOC identify an important and time-sensitive systemic threat.

Also notable was the role played by the FSOC in managing the financial stability risks related to Superstorm Sandy in the fall of 2012, when financial markets were closed for two days. The frequent meetings over this period illustrated the FSOC's effectiveness as a coordination forum and its ability to respond quickly to unexpected external events that could affect financial stability. Although the FSOC was not explicitly identified as a crisis management mechanism under the DFA, it proved helpful as a means of sharing real time information at the highest level of member agencies. However, it remains to be seen what role, if any, the FSOC would be expected to play in a crisis originating inside the financial system and coming under the responsibility (in the first instance) of one or more of its member agencies.

The OFR is an important innovation for the purpose of supporting the FSOC's work. It represents a critical component of an effective macroprudential framework because its activities – independent data and tool development and research from a system-wide perspective – will enhance the understanding, measurement and assessment of systemic risks by US authorities and thereby strengthen their ability to effectively address them.²⁵ In

²⁴ Two reports from the US General Accounting Office (GAO) to the US Congress in September 2012 and March 2013 (see <http://www.gao.gov/assets/650/648064.pdf> and <http://www.gao.gov/assets/660/653013.pdf>) recommend that the FSOC take further steps to strengthen its accountability, internal processes and transparency and improve strategic planning. Further evidence that the FSOC is a work-in-progress is illustrated by the fact that it has not yet established external technical or professional advisory committees, which are permitted under Section 111 of the DFA. The OFR has already established an advisory committee.

²⁵ The OFR has established a Data Center and a Research and Analysis Center and has made progress in developing a comprehensive database by embarking on a three-part process: (i) identifying data needs for financial stability; (ii)

attempting to achieve these ambitious goals, the OFR will need to identify the “blind spots” in the regulatory landscape and to design effective information collections to measure risks to financial stability. In addition, the OFR is uniquely placed to encourage adoption of data standards (e.g. via its work to implement the global Legal Entity Identifier initiative),²⁶ promote best practices in risk management, and support all FSOC member agencies by developing useful analytical tools that can promptly and effectively identify and monitor potential vulnerabilities in a secure environment.

Given its broad and diverse membership, the FSOC represents a significant undertaking and its decisions and actions represent the consensus view of a wide range of agencies with different mandates and interests. The structure and governance arrangements do seem to foster exchange of information, coordination and cooperation and the development of a system-wide perspective among the agencies involved. At the same time, the broad participation might affect in some cases the ability of the FSOC to take decisions in an effective and prompt manner, as the desire to reach a reasonable consensus among a large group of authorities might come at the expense of delivering clear and timely messages.

Despite the good progress made to date on systemic oversight arrangements, some issues may warrant further consideration to enhance the effectiveness of the FSOC and its operations. These are the coordinating role of FSOC; systemic risk identification and analysis; the role of the OFR; and communication.

Coordinating role of FSOC: To be effective as the macroprudential authority, the FSOC must coordinate among member agencies at two levels: facilitating a cooperative approach to systemic risk identification and analysis based on the collective expertise of member agencies, and encouraging agencies to use their existing regulatory and supervisory tools to mitigate these risks and promote financial stability. Given the size, complexity and competing interests of member agencies and the lack of a statutory directive authority, the coordinating role of the FSOC is challenging but essential to its success. The trade-off between effectiveness and inclusiveness of such a diverse body is reflected in the efforts of the Council to make decisions by consensus. To this point, this approach appears to have been reasonably successful but, for it to be even more effective in the future, it may be necessary to develop more fully and operationalise a rigorous analytical framework with clear criteria for risk identification and prioritisation (see below), well-defined objectives for risk mitigation, and a toolbox of instruments (under the control of its member agencies) that can be used for this purpose. More clarity is needed on the specification of this analytical framework and on the related processes to operationalise it, including the role played by the OFR in coordinating the data collection and analysis and the division of labour among the agencies and the OFR.

While progress has been made in the FSOC’s ability to coordinate on systemic risk identification and analysis, there is less tangible evidence on systemic risk mitigation. In

determining gaps and weaknesses, in part by cataloguing and better organizing the available data; and (iii) strengthening data standards and acquiring new data. With respect to research and analysis, reasonable progress has been made, despite staffing challenges, including via the launches of a working paper series and a fellowship program.

²⁶ This is a unique global standard for identifying parties to financial transactions. See http://www.financialstabilityboard.org/list/fsb_pa/tid_156/index.htm for details.

particular, the process that the FSOC would follow to decide on the use of microprudential instruments “owned” by member agencies for macroprudential purposes is unclear and the effectiveness of the FSOC’s coordinating role for systemic risk mitigation – particularly in areas within the statutory purview of the member agencies – has yet to be tested, especially in the case of overlapping mandates. To this end, more clarity may be needed on the extent of *ex ante* consultation within the FSOC by member agencies of their proposed rulemaking to ensure consistency of treatment, minimise the scope for regulatory arbitrage, and thereby promote overall financial stability. A recent example of regulations discussed by the FSOC – the Fed’s recent proposed FBO rules – illustrates the lack of clarity in terms of the FSOC’s precise role in this area. The FSOC could also be used as a coordinating mechanism and forum to develop a uniform US position on international financial reforms.

It is worth noting that, while the FSOC has a mandate to facilitate the coordination, collaboration and exchange of information among member agencies on regulatory and supervisory policies to identify and address systemic risks, the scope of its coordination does not extend to the impact on financial stability of other macroeconomic policies, including monetary and fiscal policies. The FSOC’s annual report identifies these policies as potential sources of threat to US financial stability – for example, the US medium-term fiscal outlook and the Fed’s low-for-long interest rate policy are identified as potential threats in the 2013 annual report – but the analysis takes these policies as exogenous.

- ***Recommendation 1: The FSOC should develop a more systematic, analytical and transparent macroprudential framework for coordinating the efforts and incorporating the bottom-up views of member agencies and the OFR to address systemic risk. This includes ensuring that microprudential policies by member agencies are coherent and consistent with the overall goal of promoting financial stability.***

Systemic risk identification and analysis: Systemic risk identification and analysis is a core function of the FSOC. While the risks or threats to financial stability are already identified in annual reports, those risks are not analysed in detail. The risks are also not prioritised in terms of their significance (i.e. likelihood and impact) or their immediacy.²⁷ The US authorities are of the view that, while there is room in certain cases to prioritise financial stability risks, the complex and constantly evolving nature of the US financial system does not easily allow such prioritisation on the basis of predefined criteria. However, although the materialisation of such risks cannot be precisely predicted *ex ante*, the FSOC could more clearly indicate its judgments about the risks of greater immediate concern. Furthermore, the scope of the risk analysis currently is relatively narrow as it tends to reflect the sectoral perspectives of individual member agencies, rather than providing a system-wide view of interconnections and exposures to risks. In that respect, it would be useful to indicate, where appropriate, which sectors of the economy would be more affected if the threats highlighted in the reports are realised and through what channels or exposures they would be transmitted. Finally, the identified risks and recommendations to address them should be tracked over time to evaluate

²⁷ The IMF, central banks and other agencies responsible for financial stability use heat maps or other methods of ordinal ranking to communicate the priority of identified risks and changes in their significance over time. This ordinal ranking can be based on objective criteria and judgment.

policy and market responses. These enhancements to the risk assessment framework can take place via the annual report or other publications (e.g. the FSOC Systemic Risk committee's *Financial Stability Monitor*) if necessary.

- ***Recommendation 2:*** *The FSOC should develop a more in-depth and holistic analysis of the systemic risks to financial stability. These risks should be prioritised, tracked over time, and separated between shorter-term conjunctural versus longer-term structural vulnerabilities. Risk identification and prioritisation should take place within a rigorous and transparent framework based on clearly defined criteria and the expert judgment of FSOC members. The recommendations to mitigate risks should be more specific as to the adopted mitigation actions, and should be monitored to assess their remedial impact.*

Role of OFR: The OFR is focused on data, analysis and research in support of the FSOC. Although its primary purpose is to fill in the gaps and help to coordinate the analyses performed by member agencies by examining the financial system as a whole, it should also challenge conventional wisdom and improve the “peripheral vision” of the FSOC. Being at arms-length from supervisors should enable it to provide independent thinking in this area. These are difficult tasks because financial stability is not a well-developed policy or academic field. Moreover, the OFR is a newcomer in a crowded field of US regulatory and supervisory agencies and it needs to carve out its role.

So far, the OFR has focused on building its capacity, setting in place a secure environment for confidential data, and finalising Memorandums of Understanding (MoUs) with member agencies. Its competitive advantages can be found in its independence, research and analytical strength, ability to collect data from regulatory “blind spots”, as well as the promotion and adoption of data standards that could improve the quality of data throughout the financial system. The OFR has already made concrete progress in supporting the FSOC’s coordinating role with data collection, analysis and research. For example, it has helped to lead the international data work on the Legal Entity Identifier (LEI) and has developed the *Financial Stability Monitor* for use by the FSOC’s Systemic Risk committee.

For the FSOC to transform itself into an effective macroprudential body that is greater than the sum of its constituent members, the OFR will need to coordinate and contribute to the work of member agencies so as to provide a system-wide perspective of risks grounded in rigorous, fact-based analysis. For example, the OFR could lead system-wide stress testing by coordinating the exercises by member agencies and providing, where appropriate, common scenarios and supporting analytical tools. In addition, because of its lack of supervisory responsibilities, its system-wide perspective and its analytical approach, the OFR is well-placed to take the lead in coordinating the monitoring of the implementation and effectiveness of policy recommendations and responses by the FSOC and member agencies, including the emergence of any unintended consequences. The OFR needs support from FSOC member agencies to be able to collect data to fill identified gaps; sufficient and secure access to key relevant data already collected by agencies; and appropriate financial and human resources to push the frontier of financial stability research and analysis.

- ***Recommendation 3:*** *The OFR’s role in supporting the FSOC’s activities should be further enhanced. The OFR should play a coordinating role in the monitoring and assessment of financial system developments as well as in the evaluation of policy*

effectiveness by leveraging its analytical strengths, its access to data and leading-edge research, and its system-wide perspective.

Communication: The FSOC’s communication to date, which takes place primarily via its annual report, is focused on addressing its accountability function to Congress and the general public, rather than providing in-depth information and analysis of its core financial stability mandate to market participants. For example, the FSOC website is organised around institutional features (reports, meetings, rules etc.) as opposed to core functions.

A key component of FSOC communication could be the set of recommendations to help promote financial stability. However, these recommendations are currently presented in the first section of the annual report and are not set out explicitly; they are often found in the middle of a paragraph. As previously mentioned, they are also not prioritized or grouped by type. It is not therefore clear whether a recommendation is new or has been carried over from prior years. More reporting of their follow-up is also needed to determine whether these recommendations have been implemented effectively.

Finally, the FSOC annual report is long and not easily accessible as a communication device. A more targeted communication strategy with multiple outlets would ensure more focused messages delivered more effectively to their intended audiences, which may differ depending on the medium.

- ***Recommendation 4:*** *The FSOC should undertake an assessment of the various target audiences for its public communication, and revise (and potentially expand) the range and adjust the content of its publications accordingly.*

3. Supervision and oversight of FMIs

Background

The FSAP made a number of recommendations relating to the supervision and oversight of FMIs,²⁸ including in the following areas:

- Access to central bank services – Allow systemic payment, clearing, and settlement infrastructures to have accounts at the Fed in order to settle in central bank money and to have emergency access to Fed liquidity under terms and conditions established by the Fed as an additional buffer against systemic risk.
- Risk management procedures – Clearing and settlement infrastructures should enhance their risk management procedures by increasing the frequency of stress testing from monthly to weekly and strengthening liquidity back-up facilities.

²⁸ FMIs in the US are defined collectively as Financial Market Utilities (FMUs) under section 803 (6) of DFA and comprise payments systems, central counterparties (CCPs), central securities depositories (CSDs) and securities settlement systems (SSSs). However, the definition does not include trade repositories (unlike FMIs as defined by PFMI). For the purposes of this document, the term FMI is used to cover these FMUs.

- Cooperation among agencies and enhanced oversight – The FSAP also recommended increasing coordination among relevant agencies and providing the Fed with oversight authority over systemically important payment, clearing and settlement infrastructure.

To a large extent, these FSAP recommendations have been addressed in the DFA. This section reviews the progress made by the US authorities in five areas: designation of systemically important FMUs (DFMUs); supervisory coordination arrangements for FMUs; enhanced prudential and oversight requirements for DFMUs; access to central bank services; and risk management procedures for FMUs.²⁹

Status of progress in main areas

Designation of FMUs: The FSOC's power to designate FMUs as systemically important stems from Section 804 of Title VIII of DFA. The statute mentions four considerations that are to be taken into account for the determination: aggregate monetary value that an FMU processes; the aggregate exposure of the FMU to its counterparties; the interdependencies with other FMUs; and the effect that the FMU's failure would have on other financial institutions or the broader financial system.

In July 2011, the FSOC published the final rule outlining the criteria, processes, and procedures for the designation of FMUs.³⁰ As previously noted, the FSOC designated eight FMUs as systemically important in July 2012.³¹ These FMUs will be subject to enhanced prudential and oversight requirements to be determined by the relevant supervisory agencies (see below). In addition, the Fed may authorise a Federal Reserve Bank to provide account, payment, and settlement services to a FMU under such conditions as the Fed may prescribe.

Supervisory coordination arrangements: The primary US supervisor of an FMU is generally determined by the FMU's activities (as set out in its charter) and the governmental authority that registered the FMU or granted permission to start operations. Each of the eight DFMUs has a primary supervisory agency (see Box 2) as follows: the two payment systems (CHIPS and CLS) are assigned to the Fed, the securities and options CCPs (FICC, NSCC, and OCC) and the central securities depository (DTC) are assigned to the SEC, while all other derivatives (primarily non-security) CCPs (CME and ICC) are assigned to the CFTC.³²

In general, the US agencies are expected to consult with each other and regulate the FMUs in

²⁹ Some of these areas are also relevant for the implementation of the April 2012 CPSS-IOSCO *Principles for Financial Market Infrastructures* (PFMIs; <http://www.bis.org/publ/cpss101a.pdf>).

³⁰ A two-stage determination process is specified: the first stage is largely data-driven to identify a preliminary set of FMUs, while the second stage is more in-depth with more weight placed on qualitative factors. See <http://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Final%20Rule%20on%20Authority%20to%20Designate%20Financial%20Market%20Utilities%20as%20Systemically%20Important.pdf> for details.

³¹ See <http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx>. There are also two systemically important publicly-owned FMUs: Fedwire Payments and Fedwire Securities. The Fedwire systems do not fall under Title VIII of DFA, but they are subject to direct oversight and supervision by the Fed and are held against standards that are the same or higher than those for DFMUs that fall under Title VIII. Other FMUs operating in the US and regulated by US (and other) agencies, but are incorporated abroad, do not fall under Title VIII of DFA.

³² Under the comprehensive framework for regulating swaps and security-based swaps established in Title VII of the DFA, the CFTC was given regulatory authority over swaps and the SEC was given regulatory authority over security-based swaps. See http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_2_Definitions/ssLINK/2012-10562a.

accordance with applicable statutory and regulatory requirements and relevant agency issued guidance. Under Title VIII of the DFA, the Fed is authorised to prescribe risk management standards for DFMUs other than those for which the SEC or CFTC is the supervisory agency (section 805 (a)). In doing so, it is required to consult with the FSOC, CFTC and SEC in the development of its risk management standards. Similarly, the CFTC and the SEC must consult with the FSOC and the Fed when developing their respective risk management standards for DFMUs for which they are the relevant supervisory agency. The CFTC and the SEC must provide the Fed copies of, and consult with the Fed before taking action on, any material change proposed by a DFMU to its rules, procedures, or operations. The SEC and the CFTC consult annually with the Fed regarding the scope and methodology of any Title VIII examinations. The Fed may, upon its discretion, participate in the examinations of the other agencies and make recommendations for enforcement actions (section 807 (e) of DFA).

Box 2: List of Designated FMUs and their Primary Supervisory Agencies

1. The Clearing House Payments Company, L.L.C., on the basis of its role as operator of the Clearing House Interbank Payments System (“CHIPS”) – Fed
2. CLS Bank International (“CLS”) – Fed
3. Chicago Mercantile Exchange, Inc. (“CME”) – CFTC
4. The Depository Trust Company (“DTC”) – SEC
5. Fixed Income Clearing Corporation (“FICC”) – SEC
6. ICE Clear Credit L.L.C. (“ICE”) – CFTC
7. National Securities Clearing Corporation (“NSCC”) – SEC
8. The Options Clearing Corporation (“OCC”) – SEC

In July 2011, the Fed, CFTC and SEC described their proposed risk management supervisory framework in a report to the US Congress in accordance with section 813 of DFA.³³ The report recommended 5 actions aimed at improving consistency in oversight, promoting robust risk management oversight, and improving the regulators’ ability to monitor risks. These actions formalise processes on how the agencies work together and consult with each other.

Supervisory coordination in terms of sharing information about FMUs, including confidential supervisory information, is outlined in section 809 (c)-(e) of DFA and in the aforementioned interagency report. Relevant agencies are authorised to notify each other of material concerns about a DFMU. The detailed procedures on exchange of information among the three agencies are based on arrangements that govern the overall agency-to-agency relationship on the sharing of confidential supervisory information. These arrangements cover issues such as how to maintain confidentiality, how to use confidential information, and who the contact

³³ See “Risk Management Supervision of Designated Clearing Entities” by the Fed, SEC and CFTC (July 2011, <http://www.federalreserve.gov/publications/other-reports/files/risk-management-supervision-report-201107.pdf>).

persons are in each agency. However, there are currently no arrangements in place (or planned) that govern supervisory cooperation for specific DFMUs; for cross-border multicurrency FMIs, for instance, MoUs are widely used to promote supervisory cooperation.

In addition, the three agencies engage in bilateral and trilateral meetings to identify emerging risks, discuss key designated CCP risk issues that may be examined by each agency, and inform effective supervisory responses to such risks. The trilateral meetings also include discussions relating to each agency's risk-management standards and the application of those standards to DFMUs. The frequency, format, and attendance of bilateral and trilateral meetings vary in relation to the subject matter addressed.

The overall framework for supervisory coordination among the Fed, SEC and CFTC is well anchored in Title VIII of DFA. As experience is gained with this process, it would be useful to review the effectiveness and efficiency of existing coordination mechanisms and to consider whether additional measures may be necessary. Such measures could include the secondment of staff across agencies and the introduction of arrangements that cover broader supervisory cooperation and not only the exchange of confidential information.

Cooperation and information sharing arrangements with foreign supervisors and overseers of FMUs are still being developed.³⁴ Nevertheless, even once these arrangements are in place, direct US oversight of foreign FMIs will still have wide cross-border reach. For example, according to the Commodity Exchange Act (CEA) §5b, for a foreign CCP providing clearing services of OTC derivatives in the US or to US persons, the CFTC's registration requirements (including the right to on-site visits) are to be applied without exemption as long as the CCP has direct and significant relations with US economy.³⁵ The CEA does not have exemptive provisions concerning on-site visits to CFTC-registered foreign CCPs or the requirements for prior consultation and consent of the local regulator. Such requirements are also not stipulated in existing individual MoUs with foreign regulators.

Enhanced prudential and oversight requirements for DFMUs: As members of CPSS or IOSCO, the Fed, SEC and CFTC are committed to adoption of the PFMI as the international standard for the regulation and oversight of systemically important FMIs, by incorporating its principles into their respective activities as soon as possible. Currently, all three agencies are in the process of adopting the PFMI into their respective regulatory frameworks.

The Fed released its final rule setting forth risk management standards for DFMUs

³⁴ The CFTC has in place cooperative oversight arrangements with foreign regulators with respect to cross-border clearing organisations, including the Alberta Securities Commission (<http://www.cftc.gov/International/MemorandaofUnderstanding/cftcascclearingmou2010>) and the UK Prudential Regulatory Authority (<http://www.cftc.gov/international/memorandaofunderstanding/ssLINK/ukfsa09>). These arrangements include provisions with respect to the scope of supervisory consultation, cooperation and exchange of information, on-site visits, permissible uses of information, and confidentiality. The CFTC is currently in the process of considering cooperative oversight arrangements with respect to cross-border clearing organizations with additional foreign regulators. The SEC has been developing MoUs or other arrangements to facilitate supervisory cooperation with foreign regulators since 2006. These arrangements establish mechanisms for consultation, cooperation, and the exchange of supervisory information, supported by confidential safeguards. Supervisory cooperation arrangements with foreign regulators that cover clearing organisations are available at http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml.

³⁵ See http://www.house.gov/legcoun/Comps/COMEX_NEW.pdf.

(Regulation HH) in July 2012.³⁶ At that time, the Fed announced its intention to seek comments on revisions to those standards based on its review of the new PFMI. The Board also plans to re-evaluate its Policy on Payment System Risk (PSR Policy) in light of the PFMI, reaffirming its long-standing policy of applying relevant international risk management standards. In March 2013, the Fed issued a Notice of Proposed Rulemaking on minimum requirements and conditions under which a Federal Reserve Bank could offer an account and services to a DFMU (see below).

The SEC published a final rule in October 2012 that requires CCPs, CSDs and SSSs registered with the SEC to establish, implement, maintain and enforce written policies and procedures that are designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.³⁷ Some PFMI principles, however, remain to be incorporated in the regulatory framework as the SEC considers the relevant FMUs' own rules (which it approves, examines and enforces) as part of the SEC's regulatory framework.

The CFTC published a new set of regulations for CCPs in 2012 based on the earlier, consultative (as opposed to final) PFMI document.³⁸ Some of the final PFMI document's higher requirements – for instance, certain principles or key considerations concerning credit, liquidity and operational risk management – have not yet been fully adopted in the current CFTC regulatory framework.³⁹ CFTC Chairman Gensler has made public statements to both Houses of Congress with respect to the CFTC's timeline for completing this process by the end of 2013, but there have been no public statements by Fed or SEC officials (or by any of the agencies) on their respective timelines for completing the implementation of the PFMI.

Access to central bank services: Section 806 (a) of Title VIII of DFA authorises the Fed to provide accounts and services to DFMUs. In March 2013, the Fed published for public comment a proposed rule setting out minimum conditions and requirements for DFMUs' accounts at the Fed and Fed's services to DFMUs;⁴⁰ the Fed is currently reviewing the responses. It should be noted that, according to DFA, the Fed “may” provide accounts to DFMUs, i.e. it is not obligated to provide such accounts.

The proposed rule intends to facilitate the use of the Fed's accounts and services by a DFMU in order to reduce settlement risk and strengthen settlement processes while limiting the risks that the DFMU could pose for the Fed. In particular, the proposed terms and conditions for DFMU access to account services at the Fed are designed to provide the Fed with sufficient information to assess the condition of the DFMU on an ongoing basis. In contrast to depository institutions, DFMUs will not have access to routine credit operations. The Fed expects that the Reserve Banks will provide accounts and services, and that DFMUs will

³⁶ See <http://www.gpo.gov/fdsys/pkg/FR-2012-08-02/pdf/2012-18762.pdf>.

³⁷ See <http://www.sec.gov/rules/final/2012/34-68080.pdf>.

³⁸ See <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister101811.pdf>.

³⁹ In August 2013, the CFTC issued final rules to implement enhanced risk management standards for systemically important derivatives clearing organisations (SIDCOs), and proposed other rules for SIDCOs that are intended to address remaining gaps between the CFTC's regulatory framework and the PFMI; see <http://comments.cftc.gov/FederalRegister/Final.aspx>.

⁴⁰ See <http://www.gpo.gov/fdsys/pkg/FR-2013-03-04/pdf/2013-04841.pdf>.

structure their settlement processes and use of Fed accounts and services, to avoid any intraday overdraft.

The framework for the provision of emergency liquidity by the Fed is outlined in section 806(b) of Title VIII of DFA. A DFMU can only obtain discount or borrowing privileges in “unusual or exigent circumstances, upon the affirmative vote of a majority of the Board of Governors” and after consultation with the Secretary of the Treasury. A necessary condition for emergency liquidity from the Fed is that the FMU demonstrates that it is unable to obtain the required funding elsewhere. There are no prescribed Fed regulations concerning the maximum amount or eligible collateral for emergency lending to DFMUs.

Risk management procedures for clearing and settlement infrastructures: As noted above, the Fed published for public comment in March 2013 a proposed rule on conditions and requirements for DFMU accounts’ access at the Fed. These conditions include rigorous liquidity risk management and access to abundant private sector liquidity sources (liquidity back-up facilities).

The CFTC finalized rules to enhance risk management procedures by requiring relevant CCPs to undergo daily and weekly stress testing (17 CFR 39.13) and by strengthening liquidity back-up facilities (17 CFR 39.11(e)(1)). The SEC adopted a rule requiring stress testing at least on a monthly basis (the NSCC and FICC increased the frequency of stress testing to weekly). SEC staff, as part of normal supervisory activities, monitors the financial risk management of each clearing agency (including the respective stress testing programs) and may consider additional regulatory action in the future as appropriate.

The strengthening of risk management procedures will be further enhanced by incorporating the PFMI in the agencies’ respective regulatory frameworks, since the PFMI set higher requirements than the FSAP recommendations on stress testing and on liquidity risk management.⁴¹ With respect to the latter, the PFMI require systemically important FMI to be able to cope with adverse liquidity stress scenarios without recourse on additional support by the central bank.

Lessons learned and issues going forward

Substantial progress has been made by the US authorities to strengthen the oversight and supervision of systemically important FMI, including by addressing the relevant FSAP recommendations. In particular, there is strong evidence of increased supervisory coordination among the relevant agencies; the Fed has been given an expanded role in the oversight and supervision of all DFMUs; there is ongoing rulemaking on enhanced prudential and oversight arrangements for DFMUs to align them with international guidance; and there is ongoing work by the Fed to define the terms of access by DFMUs to its account services.

With respect to settlement in central bank money, the Fed intends to finalise its rules on DFMUs’ account policy reflecting comments collected via public consultation. Once this process is completed, the relevant US agencies may want to consider encouraging DFMUs to

⁴¹ In particular, principle 4 of PFMI stipulates that stress testing should be conducted on a daily basis, and principle 7 stipulates that FMI should have liquidity to cover default of one or two members and affiliates.

investigate the possibility of opening a Fed account in order to use central bank money to make settlements, in accordance with Principle 9 of the PFMIIs.⁴²

A few issues remain pending or may need to be considered as the US authorities continue to enhance the supervision and oversight framework for FMIIs. These revolve around the areas of cross-border supervisory coordination; timely and transparent implementation of PFMIIs to enhance the risk management framework; and contingency planning to respond to liquidity problems at DFMUs under extreme circumstances.

Cross-border supervisory cooperation: Various legal and regulatory provisions have led to enhanced cooperation among US agencies. As in the case of domestic supervisory cooperation, continuing efforts to enhance consultation, cooperation and information sharing at the international level would promote the safety and efficiency of cross-border or multicurrency FMIIs. This is particularly relevant given the growing global importance of US-based FMIIs and the increasing reliance of some US-based market participants on FMIIs in other jurisdictions. In this regard, US agencies should further strengthen supervisory consultation, cooperation and information sharing with foreign regulators, consistent with existing international guidance,⁴³ in order to reduce the probability of gaps in regulation, supervision, and oversight and to minimise the potential duplication of effort and the burden on the FMIIs or the cooperating authorities. This may include, where appropriate, the establishment of additional cooperative oversight arrangements, adoption of MoUs and information sharing protocols, and consultation and coordination over on-site visits of supervised FMIIs.

•Recommendation 5: The US agencies should continue to enhance cooperation with foreign regulators with respect to US-based and relevant foreign FMIIs, in line with international guidance.

Implementation of the PFMIIs: Given the globalisation of financial markets, potential inconsistencies in the pace of implementation of international standards can lead to regulatory arbitrage and a non-level playing field. The enhanced prudential and oversight requirements for DFMUs specified in the regulations issued by the Fed, CFTC and SEC are a good first step, although more work is needed to fully implement the PFMIIs.⁴⁴ Although the CFTC Chairman has publicly noted the intention of completing by the end of 2013 the rulemaking process for the implementation of the PFMIIs, the US agencies note that their governance structure and rulemaking process constrain their ability to predetermine the timelines for full implementation of the PFMIIs. However, given the global importance of the US financial system, the pace of implementation of these rules can create spillovers for internationally active US firms as well as for foreign firms and jurisdictions. Delayed implementation of the PFMIIs implies, for instance, that bank capital requirements for exposures vis-à-vis CCPs will

⁴² The first sentence of Principle 9 states: “An FMI should conduct its money settlements in central bank money where practical and available.”

⁴³ Such guidance includes ‘Responsibility E’ of the PFMIIs, the May 2010 IOSCO *Principles Regarding Cross-Border Supervisory Cooperation* (<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf>), and the May 2005 CPSS *Central Bank Oversight of Payment and Settlement Systems* (<http://www.bis.org/publ/cpss68.pdf>).

⁴⁴ CPSS-IOSCO have started the process of monitoring implementation of the PFMIIs, and issued the results of the first level 1 assessment of jurisdictions’ progress in August 2013; see <http://www.bis.org/publ/cpss111.pdf>.

remain high, thereby putting relevant banks and CCPs at a competitive disadvantage. It will therefore be critical to ensure the speedy completion of rulemaking on enhanced prudential requirements, including by providing greater clarity to market participants on the indicative timelines for completing this process (while acknowledging that those timelines may need to be revised in the future).⁴⁵

- ***Recommendation 6: The US agencies should consider publishing an indicative timeline for the implementation of PFMIs to enhance regulatory transparency.***

Contingency planning: Careful consideration needs to be given to the fact that liquidity needs for DFMUs, particularly for CCPs, may fluctuate greatly and quickly during a settlement day; in extreme circumstances, emergency liquidity facilities may need to be considered. Private sector liquidity should constitute the first line of defence for CCPs against liquidity shortfalls. In conjunction with appropriate prearranged and highly reliable funding arrangements, a portfolio of liquid assets can provide a backstop against potential liquidity shortfalls. Ensuring that DFMUs fully implement enhanced prudential requirements for credit and liquidity risks (Principles 4-7 of the PFMIs), and that liquidity risks are addressed in overall contingency planning, is critical in this regard.⁴⁶

- ***Recommendation 7: The US agencies should continue to strengthen liquidity risk management for DFMUs through implementation of appropriate standards, supervisory processes as well as liquidity contingency planning and testing.***

4. Insurance supervision

Background

The FSAP and ICP assessment acknowledged that insurance regulation in the US, which is mostly carried out by the states, is generally thorough and effective, although there were a number of areas where significant development was needed.⁴⁷ These included:

- Establishing a federal office tasked with promoting greater regulatory uniformity in the insurance sector;

⁴⁵ The Federal Reserve System publishes a semi-annual unified agenda that offers estimates of further Fed action regarding specific proposals, which can be used to provide any indicative timeline for the adoption of the PFMIs. The Fed has already stated publicly its intention to review its relevant regulations in light of the PFMIs.

⁴⁶ Appropriate liquidity arrangements is one of the four safeguards identified by the FSB to help national authorities to make informed decisions on the appropriate form of CCPs to meet their G20 commitments on OTC derivatives market reforms. This safeguard is addressed within the PFMIs and also through conclusions by the Economic Consultative Committee (ECC) of the Bank for International Settlements that are included as Appendix II of the FSB's June 2012 progress report on OTC derivatives market reforms (http://www.financialstabilityboard.org/publications/r_120615.pdf). The ECC statement notes that central banks are currently working on how to ensure that there are "no technical obstacles" impeding them from providing liquidity assistance at very short notice to a fundamentally sound, but illiquid, systemically important CCP.

⁴⁷ See "United States: Detailed Assessment of Observance of IAIS Insurance Core Principles" (IMF Country Report 10/126, May 2010, available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10126.pdf>).

- Developing the supervision of insurance groups through consolidated financial reporting and establishing policies and procedures for the regulation of systemically important institutions, markets, and instruments in the insurance sector;
- Increasing information sharing and coordination between state regulators and federal authorities, including through representation of state regulators in national bodies with responsibilities for system-wide oversight;
- Strengthening the regulation of bond insurance and securities lending and modernising solvency requirements; and
- Undertaking of reforms by the NAIC⁴⁸ and state legislatures covering the terms of Commissioners' appointments, the rulemaking powers of state insurance departments, and their funding and staffing to bolster specialist skills.

This section reviews the progress made by the US federal and state authorities in these five areas, including in terms of their follow up of the relevant ICP recommendations.⁴⁹ Annex 2 provides more information on the steps taken (or planned) by the authorities in these areas.

Steps taken and actions planned

Establishment of federal insurance office: Through the DFA, the US Congress established the Federal Insurance Office (FIO) within the Treasury Department. The FIO currently has a small staff of twelve full-time employees, but it works closely with and is supported by other professionals in Treasury, FSOC and OFR. Its responsibilities, in part, are to monitor all aspects of the insurance industry (including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the US financial system); to coordinate federal efforts; and to develop federal policy on prudential aspects of international insurance matters. The FIO does not, however, have the authority to promote greater regulatory uniformity.⁵⁰

The FIO is expected to consult state regulators in carrying out its functions and has limited authority to pre-empt state law. The FIO is responsible for assisting the Secretary of the Treasury in negotiating covered agreements; such agreements can pre-empt state measures if those measures are inconsistent with the covered agreement and result in less favourable treatment of a non-US insurer domiciled in a foreign jurisdiction that is subject to a covered agreement than a US insurer domiciled, licensed, or otherwise admitted in that state. However, the responsibility for implementing state laws that are consistent with covered agreements and international standards agreed within the IAIS remains a state competence.

⁴⁸ The NAIC is the standard-setting and regulatory support organisation for the state insurance commissioners from the 50 US states, the District of Columbia, and five US territories. The NAIC assists US states in their regulatory responsibilities, by centralizing some functions (including developing so-called 'model laws') to achieve economies and greater uniformity, to pool resources, and to obtain and share expertise.

⁴⁹ The relevant principles (based on the October 2003 version of the ICPs) are: conditions for effective insurance supervision (ICP 1); supervisory authority (ICP 3); supervisory cooperation and information sharing (ICP 5); market analysis (ICP 11); reporting to supervisors and off-site monitoring (ICP12); group-wide supervision (ICP 17); and capital adequacy and solvency (ICP 23).

⁵⁰ See Section 313(c) of DFA for the full list of FIO functions.

The DFA requires the FIO to submit annual reports to the US President and Congress on the insurance industry⁵¹ and ad hoc reports on certain other insurance sector issues. Importantly, the DFA requires the FIO to submit a report to Congress on how to modernise and improve the system of insurance regulation in the US. This so-called “modernisation report” should consider systemic risk regulation with respect to insurance, capital standards, consumer protection, national uniformity, consolidated regulation, and international coordination of insurance regulation. The report is also to examine various aspects about the possibility of federal insurance regulation. That report was originally due in January 2012, but it is currently expected to be issued in the summer of 2013.

The FIO has already begun to exercise its mandate under the DFA. Its monitoring of systemic risk in the insurance sector is done using public data and, through FSOC and the IAIS, non-public data. One notable example of its role in this area has been the identification of the use of Special Purpose Vehicles and of reinsurance captives as issues requiring closer monitoring and coordinated regulatory action.⁵² In terms of its involvement with state regulators in efforts to promote greater regulatory uniformity, the FIO has highlighted its ongoing work on the EU-US Dialogue Project.⁵³

Insurance group supervision: The FSAP found that while the state-based regulatory system was effective in assuring policyholder protection and the soundness of individual insurance companies, it lacked a systemic focus and the capacity to exercise group-wide oversight.

The DFA established a framework for the regulation of systemically important institutions in the insurance sector through the ability of the FSOC to determine non-bank financial companies as systemically important and therefore subject to more stringent prudential standards and consolidated supervision by the Fed (see section 2). The Director of the FIO serves in an advisory capacity on the FSOC; the Director and a state insurance representative are among the 5 non-voting members of the Council. The FSOC issued rules on the process for designating nonbank financial companies, including insurance companies, in April 2012.⁵⁴ In July 2013, the FSOC designated one insurance group (AIG) as systemically important, while another (Prudential) announced in a public filing that it is appealing its proposed designation. The DFA allows the Fed to tailor the enhanced prudential standards to reflect the business model, capital structure and risk profile of the designated company. The

⁵¹ The first annual report was submitted in June 2013 (<http://www.treasury.gov/initiatives/fio/reports-and-notice/Docs/FIO%20Annual%20Report%202013.pdf>).

⁵² FIO has closely monitored this issue and state regulator activity, and highlighted the topic during the March 2013 meeting of the Federal Advisory Committee on Insurance (FACI). The role of FACI is to provide advice and recommendations to the FIO in order to assist it in carrying out its duties and authorities.

⁵³ This project was established in January 2012 to increase mutual understanding and cooperation between the EU and the US in the area of insurance for the benefit of consumer protection, business opportunity and effective supervision. More background to this project can be found in the factual report produced in December 2012 (https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/EU_US_Dialogue_Project_Factual_Report.pdf).

⁵⁴ For nonbank financial companies, the rule lays out a three-stage process leading to a proposed determination and provides guidance for the assessment. The first stage is based on quantitative thresholds comprising, among other things, measurements of size, indebtedness, and leverage, which could help identify firms that could pose a threat to US financial stability. The second and third stages of the Council’s designation process consist of a more thorough evaluation based on quantitative and qualitative considerations, which also take into account company-specific and industry-specific information.

development of such measures for designated non-bank financial companies is currently underway.

In terms of developments at state level, the NAIC adopted in 2010 changes to the *Insurance Holding Company System Regulatory Act* (Model 440) and the *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (Model 450).⁵⁵ If adopted by the states (thus far, 15 states have adopted the revised models), these changes would reinforce the authority of state insurance commissioners to obtain the financial statements of an insurance holding company (IHC) and any affiliates within the holding company system. The revisions also introduced the requirement for all groups to submit an Enterprise Risk Report disclosing potential contagion or financial risks to the insurer. The revised IHC Models have further assisted in the formation of international and regional supervisory colleges within the US.

In 2012, the NAIC adopted the Risk Management and Own Risk Self-Assessment (ORSA) model. Under this model, which is due to be implemented by 1 January 2015, all large groups (comprising over 90% of US premium volume) will have to provide an internal assessment of the risks associated with their business and the sufficiency of their capital resources to support these risks. The states of Iowa, Rhode Island and Vermont recently passed laws to implement the ORSA and similar measures are on the 2014 agenda of other state legislatures.

Since the FSAP, a single lead supervisor has been assigned to each of the 320 US insurance groups, with responsibility for coordination with the other state supervisors and the insurance group, undertaking holding company analysis, and leading the supervisory college. The criteria for determining the lead supervisor include the location of the group's head office and the location of the largest insurance operations with flexibility for states to agree on a different lead supervisor, where considered appropriate. However, state regulators only have direct supervisory powers in relation to regulated insurance entities and cannot apply consolidated capital requirements and supervision to insurance groups.

Information sharing and coordination between state regulators and federal authorities: As part of its responsibility for coordinating and developing federal policy on prudential aspects of international insurance matters, the FIO regularly consults other relevant federal agencies. Regular contact between the FIO and the NAIC also takes place through dedicated bilateral meetings and joint participation in international discussions of the IAIS. Some efforts have been made to coordinate positions at the international level where representatives from state regulators, the NAIC and the FIO participate, although only the FIO currently has the legal authority to represent the US.⁵⁶

The FIO is able to collect information from insurers and their affiliates, and coordinates with other federal agencies and state regulators when doing this. The framework for information sharing between the FIO, NAIC and state regulators is established through the FIO's legal

⁵⁵ Model laws and regulations are a set of regulatory standards that require state legislative enactment to become legally effective. The NAIC Accreditation Program assesses states' compliance with these standards and they provide the mechanism by which state regulators hold each other accountable.

⁵⁶ State regulators only represent the views of the individual states and the NAIC is not a supervisory authority.

powers on information collection under the DFA and a MoU between the NAIC and Treasury under which the FIO has access to a data portal containing non-confidential information.⁵⁷

State regulators coordinate with the Fed on the supervision of BHCs and savings and loan holding companies (SLHCs) with insurance operations that are subject to consolidated supervision (currently around 21 firms), and MoUs are in place between the Fed and each relevant state regulator. The NAIC recently hosted a meeting with the Fed to discuss group supervision and information sharing. State regulators can receive information about insurance operations obtained by the Fed during onsite examinations. The NAIC has also entered into MoUs with other national authorities and foreign regulators since the FSAP.

Bond insurance and solvency requirements: Life insurers that engaged in securities lending business were negatively affected by illiquid markets during the financial crisis as a result of reinvesting cash collateral in illiquid instruments. The NAIC has sought to address this regulatory concern by introducing requirements for insurers to disclose details of “reinvested” collateral assets and revising the accounting guidance to require guarantors to disclose information about each guarantee or group of similar guarantees, as well as the nature of the relationship with the beneficiary of the guarantee or undertaking.

The FSAP recommended that state regulators place more emphasis on principle and risk-based techniques, as well as on improving the reserving requirements for insurance products with guarantees. The NAIC’s introduction of principle-based reserving (PBR) for life insurers is a significant step towards making the US reserving⁵⁸ requirements less formulaic. The improved risk-based calculation is intended to capture complex guarantees (such as those associated with variable annuities business) and make it more difficult for insurers to circumvent requirements. PBR will be effective following a three-year transition period after the revisions are adopted by at least 42 states representing 75% of total US premium.⁵⁹ The FIO is closely monitoring state regulatory developments in this area.

In relation to the modernization of solvency requirements, the NAIC revised its Financial Condition Examiners Handbook in 2012 to introduce company stress testing of liquidity risks, the results of which may need to be provided to supervisors at any time. The EU-US Dialogue Project objective as regards solvency and capital requirements, which will be pursued over the next 5 years, is also relevant in this context.

The NAIC has tentatively concluded that an overall safety level for reserving and capital requirements, as recommended by the FSAP, is not achievable due to insufficient data and is unnecessary given the role of Risk-Based Capital in the solvency framework. Instead, the NAIC has noted that safety level targets exist for certain risk types, which vary by risk class and are largely based on the estimated timing of failure by each risk type.

⁵⁷ The FSOC has access to confidential information in relation to insurance groups that have been identified as potentially systemically important during stage 1 of the designation process.

⁵⁸ The US uses the terminology of reserves, which are referred to as technical provisions in the IAIS ICPs.

⁵⁹ As of April 2013, only Arizona, Indiana and Tennessee had enacted this legislation, while 7 further states (Connecticut, Louisiana, New Hampshire, Rhode Island, Texas, Maine, Ohio) are at different stages of introducing legislation and three states have it on their 2014 agenda (Massachusetts, Nevada, Nebraska).

Governance and funding reforms: While the NAIC has discussed the FSAP recommendation on governance and funding reforms at several national meetings with state regulators and within its Corporate Governance Committee, no NAIC-coordinated reforms have been made or are planned. Only the state of New Mexico has signed legislation under which the Superintendent of Insurance would be selected by a bipartisan committee for a four-year term and can be removed solely for incompetence or malfeasance.

With regard to the funding and staffing of state insurance departments, the NAIC and state regulators consider that state departments have resources with knowledge and experience and the flexibility to contract additional expertise as required. These resources may be supplemented by leveraging the centralized resources available at the NAIC. A regular staff exchange initiative has also been introduced for states to assist each other with training for financial analysis and examinations.

Lessons learned and issues going forward

The US authorities have begun to address the insurance-related FSAP recommendations. In particular, Congress established the FIO under the DFA (albeit not with the explicit legal authority to promote greater regulatory uniformity in the insurance sector), while the FSOC recently designated one insurance company as systemically important and therefore subject to consolidated supervision and enhanced prudential standards by the Fed. Information sharing and coordination between state regulators and federal authorities has increased. In addition, state authorities have taken useful steps to improve insurance group supervision; to modernise solvency requirements; and to improve disclosures required for securities lending operations by insurance companies.

In spite of these accomplishments, however, significant additional work is required to fully address the FSAP recommendations, particularly in terms of promoting greater regulatory uniformity, enhancing group supervision, modernising solvency requirements, and adopting governance and funding reforms at state level.

Regulatory uniformity: A forthcoming report by the FIO to Congress and the President will set forth how to modernise and improve the system of insurance regulation in the US and, among other factors, will consider the degree of national uniformity of state insurance regulation. The FSAP noted the difficulties in verifying the implementation of requirements in a state-based system with over 50 separate authorities. States continue to retain almost exclusive competence for insurance regulation. While the NAIC, through its Financial Regulation Standards and Accreditation Program,⁶⁰ plays an important role in promoting consistency between states, the fact that it is not a supervisory authority and that state laws must only be “substantially similar” to the NAIC’s model laws allows for divergent approaches, which may impact the consistency of supervision applied to large insurance groups with national and international reach.

⁶⁰ Accreditation standards are minimum standards against which states are assessed on a five yearly cycle. In order to be accredited, a state must have in force laws that are substantially similar, and no less effective, to the significant elements that have been identified as the key provisions of the model law or regulation.

The architecture for insurance supervision in the US, characterised by the multiplicity of state regulations, the absence of federal regulatory powers to promote regulatory uniformity and the limited rights to pre-empt state law, constrains the ability of the US to ensure regulatory uniformity in the insurance sector. While the FIO represents the US on international insurance matters and negotiates covered agreements, only the states have the authority (but are under no legal obligation) to implement laws that are consistent with those agreements and international standards agreed within the IAIS. Given the drawbacks of the current regulatory set-up, the US authorities should carefully consider and provide recommendations to Congress as to whether migration towards a more federal and streamlined structure may be a more effective means of achieving greater regulatory uniformity.

The FIO's current human resources may need to be augmented to fully address the tasks that it has been mandated under DFA, in particular identifying gaps that could contribute to systemic risk in the insurance sector and developing federal policy on prudential aspects of international insurance matters. The FIO should enhance its monitoring of the sector through greater use of non-public information that it is able to access, and be given more resources and powers to be able to address issues and gaps that it identifies.

- ***Recommendation 8: The US authorities should promote greater regulatory uniformity in the insurance sector, including by conferring additional powers and resources at the federal level where necessary. The FIO should enhance its monitoring of the sector through increased use of non-public information, and be further strengthened to be able to take action to address issues and gaps identified.***

Enhanced insurance group supervision: State insurance regulators have taken some positive steps to develop the supervision of insurance groups. If adopted by the states, the NAIC's December 2010 changes to the IHC Models will give insights to supervisors into groups' own perspective of their risks through the Enterprise Risk Report. To date, however, only 15 states have adopted the revised models. In order to be effective, the NAIC will need to make these revisions mandatory for accreditation and the remaining states that have yet to change their laws will need to enact these models. In addition, the FSOC's designation process will ensure consolidated supervision for systemically important insurance groups. In developing tailored requirements for such groups, the Fed will need to pay particular attention to the specificities of the insurance business model (in particular, the risks associated with insurance liabilities) in order to ensure effective group supervision for these companies.

Notwithstanding this progress, the FSAP recommendation for consolidated financial reporting requires a number of additional steps to be taken by the US authorities. Group-wide consolidated data and the financial statements of affiliates within an insurance group are not systematically collected and data is usually only requested by regulators in those instances where it has been produced for other mandated purposes.⁶¹ This constrains the ability of state authorities to effectively supervise all insurance groups and to analyse events that might impact the group as a whole, absent a framework for consolidated regulation and supervision.

⁶¹ For example, insurers belonging to publicly traded groups file consolidated company financial statements to the SEC (this represents approximately 60% of the insurance premium in the US).

State regulators are able to prevent certain transactions between insurers and affiliates or holding companies (for example, through the prior approval of extraordinary dividends). However, no additional powers have been conferred on state regulators with respect to holding companies – for example, the ability to license such companies or to direct them to make changes at the group level to rectify any shortcomings. Consequently, state regulators rely on achieving outcomes indirectly via the regulated entities of a holding company.

The NAIC is understood to be considering a group capital assessment that would draw on the information received as part of the ORSA,⁶² which represents a positive and a welcome development. Aside from this, however, no action has been taken in relation to the FSAP recommendation to use quantitative techniques and practices or to apply insurance capital requirements to the consolidated insurance group. This means that no adjustments are made by states to address any intra-group creation of capital caused by multiple gearing. At present, consolidated capital requirements and supervision are only applicable to a small number of insurance groups that are BHCs or SLHCs and thereby subject to Fed supervision, and prospectively to insurance companies designated by the FSOC as systemically important.

- ***Recommendation 9: The US authorities should further enhance insurance group supervision by introducing requirements for consolidated financial reporting for all insurance groups. Lead supervisors should be given additional powers to fully assess the financial condition of the entire insurance group, such as having direct powers over holding companies.***

Modernisation of solvency requirements: The NAIC has followed up on the FSAP recommendation by changing the accounting and disclosure requirements for securities lending business and by introducing PBR, which should ensure more appropriate reserves for life insurance products. As PBR is enacted by the states, the NAIC and state regulators will need strong actuarial expertise and regulatory tools to deal with the complexities of a less formulaic framework. Further work is needed to revise capital requirements in light of PBR and to evaluate the appropriateness of the capital treatment of market risks associated with life insurance products.

The FSAP acknowledged that the state-based “liability reserving methods and bases generally lead to conservative estimates and, in combination with capital requirements, provide a sizable buffer against adverse experience”. Notwithstanding this, however, the FSAP’s expressed concerns that it is difficult to make peer comparisons across insurers and against other international insurance regimes due to the absence of a target safety level of reserving and an associated target safety level for capital remain valid, despite the NAIC’s assertion that an overall target safety level is unachievable and unnecessary. Moreover, the safety level targets for individual risks are in most cases not set out in NAIC models. The FIO is closely monitoring these regulatory developments.

- ***Recommendation 10: State authorities should continue to modernise solvency requirements through enacting PBR into state law and the NAIC should take***

⁶² See the Solvency Modernisation Initiative White Paper for details (http://www.naic.org/documents/index_smi_exposures_smi_white_paper.pdf).

measures to clarify the safety level targets for individual risks and the overall effect of reserving and capital requirements in its model laws.

Governance and funding reforms: While the vesting of regulatory powers in the State Insurance Commissioner in principle ensures that departments are operationally independent, the ability of the governor in most states to dismiss Commissioners at any time, and without a public statement of reasons, continues to expose departments to potential political influences. The NAIC should continue to provide the FSAP recommendation as guidance to states, and state regulators should take steps to introduce fixed term appointments for Commissioners.

The NAIC and state regulators are of the view that the funding and staffing of state regulators is sufficient and that no further reforms are necessary at this time. However, the need to bolster specialist skills (such as actuarial expertise) will significantly increase following the introduction of ORSA and PBR.

Recommendation 11: State authorities should implement the FSAP recommendation concerning the terms of state Commissioners' appointments, the rulemaking powers of state insurance departments, and their funding and staffing to bolster specialist skills.

Annex 1: Structure of the financial system and regulatory developments

Financial system structure

Financial markets in the US are the largest and most liquid in the world. In 2011, finance and insurance represented 8.3% (or nearly US\$1.3 trillion) of US gross domestic product (GDP). The financial services and insurance sectors employed 5.8 million people in 2011.

Banking: Insured depository institutions make up the largest group of financial institutions. These institutions accept deposits from both retail and institutional savers and, among other activities, make loans to businesses and consumers. In order for an insured depository institution to accept customer deposits, it must be insured by either the FDIC or the NCUA and chartered as a commercial bank, savings and loan association, credit union, or industrial loan company, and be subject to the accompanying oversight, regulation, and activity restrictions. A company must be a financial holding company (FHC), savings and loan holding company (SLHC) or bank holding company (BHC) in order to own an insured depository institution, with some exceptions (such as certain industrial loan companies). Many of the largest insured depository institutions are part of BHCs and may be affiliated with non-depository institutions, such as security broker-dealers. Subsidiaries of FHCs, SLHCs and BHCs may also include investment companies, or insurance companies. However, there are rules that restrict the transactions that can occur between insured depository institutions and their affiliates.

As of end-2012, the US domestic banking industry was composed of 7,083 commercial banks and savings institutions. Approximately 2,205 institutions had assets under \$100 million, while 4,216 institutions had assets between \$100 million and \$1 billion, and 662 institutions had assets over \$1 billion. In addition, there were 6,819 credit unions in the fourth quarter of 2012. As of the fourth quarter of 2012, there were 1,014 top-tier BHCs in the US, with aggregate assets of about \$16.6 trillion. Aggregate pre-tax income of BHCs totalled \$159 billion in 2012, an increase of 8% from 2011. Average Tier 1 capital ratios for BHCs were 11.46% at end-2012. In addition to the US BHCs, foreign bank families have a large presence in the US. Together, the US branches and agencies of foreign banks account for more than \$2 trillion of banking assets.

Broker-dealers: Security broker-dealers facilitate activities in a variety of capital markets, including equity, fixed income, currency, and commodity securities, and derivatives. As part of these activities, firms provide financial advisory services and underwrite the issuance of equity, debt, and other securities. They also facilitate the buying and selling of securities and derivatives by acting as a market maker. Prior to 2008, many of the largest security broker-dealers operated as independent investment banks, but due to mergers with or conversions to bank holding companies, now all of the largest security broker-dealers are subsidiaries of bank holding companies. As of the fourth quarter of 2012, there were 4,358 domestic and foreign-owned securities broker-dealers operating in the US. The US broker-dealer sector is relatively concentrated: approximately 60% of industry assets were held by the top 10 broker-dealers at the end of last year, the largest of which were affiliated with foreign banks and domestic BHCs. Assets held by US broker-dealers have stabilized around 25% below the pre-crisis 2007 peak, reaching \$4.8 trillion in the fourth quarter of 2012.

Insurance: Property casualty companies insure business and household assets as well provide liability coverage. Life insurance companies provide asset accumulation products and benefits to a designated beneficiary in the event of the policyholder's death or insured event. US-based insurers are also significant participants in global financial markets. Excluding firms licensed solely as health insurers or health maintenance organizations, the life and health (L/H) sector held approximately \$5.6 trillion of total assets, while the property and casualty (P/C) sector held approximately \$1.6 trillion as of year-end 2012. Of the combined \$7.3 trillion in total assets, \$6.8 trillion were invested assets. Insurance premiums in L/H and P/C insurance sectors totalled more than \$1.1 trillion in 2012, or approximately 7% of US GDP. The L/H sector accounts for about 58% of industry net written premiums, while the P/C sector accounts for 42%. The US insurance industry currently has more than 1,000 L/H insurers and more than 2,700 P/C insurers.

Investment companies and funds: The US financial system includes a number of different types of investment companies that purchase assets in both the public and private markets. Mutual funds, which are typically sold to the public, are the largest type of investment company, with over \$9 trillion in financial assets. Money market mutual funds, which are sold to both public and institutional investors, invest only in certain risk-limited, shorter-term investments, hold an additional nearly \$3 trillion in financial assets. As of the third quarter 2012, the combined assets under management of private and public pensions, including federal pensions and defined contribution plans, were over \$16 trillion. If insurance assets and mutual funds are included, US asset managers held more than \$36 trillion of long-term conventional assets in 2010, or 45% of the global total for these funds.

In addition, there are a number of alternative investment vehicles, sold only to certain sophisticated investors, including hedge funds and private equity firms. In 2010, venture capital-backed companies employed more than 12 million people and generated nearly \$3 trillion in revenue. Respectively, these figures accounted for 11% of private sector employment and represented the equivalent of 21% of US GDP during that same year. US private equity assets under management increased to nearly \$2 trillion in 2012. Although leveraged buyout funds account for 39% of US private equity assets under management, advisers continue to diversify their investment strategies into such areas as real estate, natural resources, distressed assets, and emerging market opportunities.

Government-sponsored enterprises: Certain government-sponsored enterprises (Fannie Mae, Freddie Mac, and the Federal Home Loan Banks) play an important role in the financing of residential mortgages and collectively have over \$6 trillion in financial assets. These institutions facilitate liquidity in the secondary mortgage market by guaranteeing and purchasing loans from mortgage lenders and by providing funding to financial institutions for mortgage lending.

Regulatory structure

The US regulatory system includes four independent federal regulators of depository institutions. The Board of Governors of the Federal Reserve System (Fed) is the consolidated supervisor of FHCs, BHCs, and SLHCs, and the joint primary supervisor with the respective state authorities of state chartered banks that are Federal Reserve System members and state-chartered uninsured branches and agencies of foreign banks. The Federal Deposit Insurance

Corporation (FDIC) is the joint primary supervisor with the respective state authorities of state-chartered banks that are not Federal Reserve System members, state-chartered thrifts, and state-chartered insured branches and agencies of foreign banks. In addition, it serves as a backup supervisor of state member banks, national banks, and federal thrifts, and is the deposit insurer and presumptive receiver of all commercial banks and thrifts. The Office of the Comptroller of the Currency (OCC) is the chartering authority and primary supervisor of national banks and federal savings associations as well as the primary supervisor of federally-chartered US branches of foreign banks. The National Credit Union Administration is the chartering authority and supervisor of federal credit unions and deposit insurer of all federal and state credit unions. There are also 50 state regulators of state-chartered commercial banks, 50 state regulators of state-chartered savings associations, and 50 state regulators of state-chartered credit unions.

The Securities and Exchange Commission (SEC) is the primary federal regulator for securities market participants. These include securities broker-dealers, investment advisors, investment companies, transfer agents, credit rating agencies, alternative trading systems, self-regulatory organizations (including the Financial Industry Regulatory Authority, the Municipal Securities Rulemaking Board, clearing agencies that help facilitate trade settlement, securities exchanges and securities associations), [security-based swap dealers](#), [major security-based swap participants](#), [security-based swap data repositories](#) and [securities-based swap execution facilities](#). The Commodity Futures Trading Commission (CFTC) is responsible for overseeing the derivatives markets subject to the Commodity Exchange Act, as amended by the DFA, which includes the swaps and futures markets, swap dealers and major swap participants, designated contact markets, foreign boards of trade, swap execution facilities, designated clearing organizations, futures commission merchants, introducing brokers, commodity trading advisors, and commodity pool operators.

Prudential regulation of the insurance industry is regulated primarily by the states, with the National Association of Insurance Commissioners (NAIC) acting as a coordinating body. The Federal Insurance Office (FIO), within the US Department of the Treasury, was created as part of the Dodd-Frank Act to, among other responsibilities, gather information, monitor the insurance industry, including identifying issues or gaps in regulation, make recommendations to the FSOC on insurers to be designated for enhanced supervision, and represent the US, as appropriate, in the International Association of Insurance Supervisors (IAIS).

The Consumer Financial Protection Bureau (CFPB) was created as part of the Dodd-Frank Act to serve as the primary federal consumer financial protection supervisor and the enforcer of federal consumer protection. To create a single point of accountability in the federal government for consumer financial protection, the Dodd-Frank Act consolidated many of the consumer financial protection authorities previously shared by seven federal agencies into the CFPB and provided the Bureau with additional authorities to:

- Conduct rulemaking, supervision and enforcement with respect to the Federal consumer financial laws;
- Handle consumer complaints and inquiries;
- Promote financial education;
- Research consumer behavior; and

- Monitor financial markets for risks to consumers.

The Federal Housing Finance Agency (FHFA) is responsible for the supervision, regulation, and oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks to promote their safety and soundness, support housing finance, affordable housing, and a stable and liquid mortgage market.

Regulatory developments

Dodd-Frank Act implementation included further strengthening of supervision, capital, and risk-management standards for financial institutions and financial market utilities; procedures for periodic supervisory and company-run stress tests; rulemakings related to the orderly liquidation authority; regulation of the derivatives markets to reduce risk and increase transparency; new standards to protect mortgage borrowers and reduce risks in the mortgage market; and other measures to enhance consumer and investor protection.

In addition to the reforms described in this document, other major regulatory reforms include:

- *Large Financial Institutions*: The Fed issued a new framework for the consolidated supervision of large financial institutions in December 2012. This framework strengthens traditional microprudential supervision and regulation to enhance the safety and soundness of individual firms, and incorporates macroprudential considerations to reduce potential threats to the stability of the financial system. The new framework has two primary objectives of enhancing the resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary and reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness.
- *Short-Term Investment Funds*: The OCC adopted a final rule in October 2012 to revise requirements for national banks, federal savings associations, and federal branches of foreign banks that act as a fiduciary and manage short-term investment funds (STIFs). The final rule adds safeguards designed to address the risk of loss to a STIF's principal, including measures governing the nature of a STIF's investments, ongoing monitoring of its mark-to-market value, and forecasts of potential changes in a STIF's mark-to-market value under adverse market conditions. The final rule also requires greater transparency and regulatory reporting on a STIF's holdings, as well as procedures to protect fiduciary accounts from undue dilution of their participating interests in the event that the STIF loses the ability to maintain a stable net asset value.
- *Orderly Liquidation Authority*: Title II of the Dodd-Frank Act establishes a new framework, the orderly liquidation authority (OLA), to address the potential failure of a bank holding company or other financial company when the failure of the financial company and its resolution under the Bankruptcy Code or otherwise applicable federal or state law would have serious adverse effects on financial stability in the US. In October 2012, the FDIC adopted, after notice and comment, a final rule clarifying the conditions and requirements governing the FDIC's exercise of its authority to enforce certain contracts of subsidiaries or affiliates of a financial company placed into OLA notwithstanding contract clauses that purport to terminate, accelerate, or

provide for other remedies based on the insolvency, financial condition, or receivership of the financial company. In addition, the FDIC will be proposing additional rules to implement or clarify certain other aspects of OLA, as necessary.

- *Over-the-Counter Derivatives Reform*: Title VII of the Dodd-Frank Act establishes a comprehensive new regulatory framework for swaps and security-based swaps. In July 2012, the SEC and CFTC approved foundational joint final rules to further define the terms “swap,” “security-based swap,” “mixed swap,” and “security-based swap agreement.” This effort followed the CFTC’s and the SEC’s April 2012 adoption of joint final rules, which further defined the terms “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” and other terms. The entity and product definitional rules went into effect in July and October 2012, respectively, and triggered compliance with other final rules adopted previously by the CFTC.
- *Swap and Security-Based Swap Regulatory Reform*: A number of significant elements of the CFTC’s swap regulatory regime became effective in the fourth quarter of 2012 and in the first quarter of 2013. Swap dealer registration began in advance of 31 December 2012, and 79 swap dealers and 2 MSPs provisionally registered with the CFTC as of 5 July 2013. Other entities are expected to register over the course of 2013 once they exceed the de minimis threshold for swap dealing activity. Swap dealers (and major swap participants or MSPs) are subject to a number of specific regulatory standards, including internal and external business conduct, recordkeeping and documentation requirements, and real-time and regulatory reporting obligations.
- *Capital and Margin Requirements*: Federal prudential regulators (Fed, FDIC, OCC, FHFA, and the Farm Credit Administration), the CFTC, and the SEC issued proposed rules on capital and margin requirements for non-centrally cleared swaps. The proposed margin requirements would require swap dealers, security-based swap dealers, MSPs, and major security-based swap participants to collect initial and variation margin on non-centrally cleared swap transactions from their counterparties.

Annex 2: Steps taken and actions planned on FSAP insurance-related recommendations

<p>FSAP Recommendation 1: Establish a federal office tasked with promoting greater regulatory uniformity in the insurance sector.</p> <p><i>This recommendation was assigned a medium priority and was to be completed in the medium term (1-3 years).</i></p>	
<p>What follows in this section are selected excerpts of DFA; the full text is available at http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.</p> <p>The Federal Insurance Office (FIO) was established under the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) in July 2010. The FIO has been established within the Department of the Treasury. The Office is headed by a Director, who is appointed by the Secretary of the Treasury. The Office, pursuant to the direction of the Secretary, has the authority to a) to monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the US financial system; b) to monitor the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance; c) to recommend to the FSOC that it designate an insurer, including the affiliates of such insurer, as an entity subject to regulation as a nonbank financial company supervised by the Fed; d) to assist in administering the Terrorism Insurance Program established in the Department of the Treasury under the Terrorism Risk Insurance Act of 2002; e) to coordinate Federal efforts and develop Federal policy on prudential aspects of international insurance matters including representing the US, as appropriate, in the International Association of Insurance Supervisors and assisting the Secretary in negotiating covered agreements; f) to determine whether State insurance measures are pre-empted by covered agreements; g) to consult with the States (including State insurance regulators) regarding insurance matters of national importance and prudential insurance matters of international importance; and h) to perform such other related duties and authorities as may be assigned to the Office by the Secretary.</p> <p>The Director of the FIO serves in an advisory capacity on the FSOC established under the Financial Stability Act of 2010. The DFA lays down the scope of the authority of the Office, which excludes health insurance, long-term care insurance (except long-term care insurance that is included with life or annuity insurance components) and crop insurance as established by the Federal Crop Insurance Act.</p> <p>The FIO has also been tasked with the gathering of information in carrying out its functions. It may a) receive and collect data and information on and from the insurance industry and insurers; b) enter into information-sharing agreements; c) analyze and disseminate data and information; and d) issue reports regarding all lines of insurance except health insurance. In acting in accordance with these provisions, the FIO may exclude insurers below a certain size threshold. The FIO is required to carry out advance coordination with federal and state regulators and agencies and any publicly available sources when collecting data or information. Where such information as is required by the FIO, is not available from other sources, it may be collected directly from companies. The submission of any non-publicly available data and information to the FIO is covered in terms of retention of privileges as regards confidentiality arising under federal or state law to which the data or information is otherwise subject. Any data or information obtained by the FIO may also be made available to State insurance regulators, individually or collectively, through an information-</p>	<p>FIO</p>

sharing agreement. The Treasury and the NAIC have signed an MoU that facilitates information sharing between the FIO and the NAIC.

The FIO is expected to consult with state regulators, individually or collectively, as appropriate, in carrying out its functions. Nothing in the Federal Insurance Office section of the DFA pre-empts any State insurance measure that governs any insurer's rates, premiums, underwriting, or sales practices; any State coverage requirements for insurance; the application of the antitrust laws of any State to the business of insurance; or any State insurance measure governing the capital or solvency of an insurer, except to the extent that such State insurance measure results in less favourable treatment of a non-United State insurer than a US insurer and the measure is inconsistent with a covered agreement. A covered agreement is a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that is entered into between the US and one or more foreign governments, authorities, or regulatory entities, and relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.

Section 313 of the DFA requires that beginning September 30, 2011, the FIO shall submit a report on or before September 30 of each calendar year to the President and to the Committees on Financial Services and Ways and Means of the House of Representatives and the Committees on Banking, Housing, and Urban Affairs and Finance of the Senate on any actions taken by the FIO regarding pre-emption of inconsistent State insurance measures. One such report has been issued, in late 2012, which states that, "During the year ending September 30, 2012, FIO did not take any actions regarding the pre-emption of any State insurance measure." The report is available on FIO's website at <http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2012%20Preemption%20Report.pdf>.

The DFA also requires, beginning September 30, 2011, the FIO to submit an annual report on the insurance industry and any other information as deemed relevant by the Director or requested by such committees. The first of these reports was published in June 2013.

Reports are pending on: (i) US and Global Reinsurance markets, describing the breadth and scope of the global reinsurance market and the critical role such market plays in supporting insurance in the US – due no later than September 30, 2012; and (ii) the impact of Part II of the Non-admitted and Reinsurance Reform Act of 2010 on the ability of State regulators to access reinsurance information for regulated companies in their jurisdictions – due no later than January 1, 2013.

Not later than 18 months after the enactment of DFA, the FIO was required to conduct a study and submit a report to Congress on how to modernize and improve the system of insurance regulation in the US. The study and report was required to be based on and guided by the following considerations:

1. Systemic risk regulation with respect to insurance;
2. Capital standards and the relationship between capital allocation and liabilities, including standards relating to liquidity and duration risk;
3. Consumer protection for insurance products and practices, including gaps in State regulation;
4. The degree of national uniformity of State insurance regulation;
5. The regulation of insurance companies and affiliates on a consolidated basis;

6. International coordination of insurance regulation.

The study and report is also required to examine the costs and benefits of potential Federal regulation of insurance across various lines of insurance; feasibility of regulating only certain lines of insurance at the Federal level, while leaving other lines of insurance to be regulated at the State level; ability of any potential Federal regulation or Federal regulators to eliminate or minimize regulatory arbitrage; impact that developments in the regulation of insurance in foreign jurisdictions might have on the potential Federal regulation of insurance; ability of any potential Federal regulation or Federal regulator to provide robust consumer protection for policyholders; and potential consequences of subjecting insurance companies to a Federal resolution authority. The study and report is also required to contain any legislative, administrative, or regulatory recommendations, as the Director, FIO determines appropriate, to carry out or effectuate the findings set forth in the report.

The FIO identifies issues or gaps in the regulation of the US insurance industry and has brought some of the issues it is examining to the attention of state regulators and the public. In fulfilling its statutory mandate, FIO receives non-binding advice from the Federal Advisory Committee on Insurance (“FACI”). The FACI meets on average four times a year and is composed of 15 members representing the views of State and non-government persons, industry experts. One notable example of the role the FIO has played in monitoring the insurance industry is the identification by the FIO of the use of Special Purpose Vehicles and of reinsurance captives as issues requiring closer monitoring during the March 2013 meeting of the Federal Advisory Committee on Insurance.

The FIO has pointed to its involvement with state regulators in the EU-US Dialogue Project as an example of how it has promoted greater regulatory uniformity. Among the topics addressed through the Project are group supervision, capital and the ability of supervisors to exchange information confidentially. FIO is also actively engaged in several work streams at the International Association of Insurance Supervisors (IAIS) dedicated to improving risk-based and group-wide supervision. Through its membership in the FSOC and IAIS’ Financial Stability Committee, FIO has also been involved actively in the development of the domestic and international processes to designate systemically important insurers.

FSAP Recommendation 2: Develop the supervision of insurance groups through consolidated financial reporting and establish policies and procedures for the regulation of systemically important institutions, markets, and instruments in the insurance sector.

This recommendation was assigned a high priority and was to be completed over the medium term.

Recommendations on Market analysis (ICP 11), Reporting to supervisors and off-site monitoring (ICP 12) and Group-wide supervision (ICP 17)

ICP 11 was considered to be LO (largely observed) and the FSAP recommended that regulators should collect more complete group-wide consolidated data for insurance groups and broader financial conglomerates. The regulators should further strengthen their analysis of developments outside the U.S. markets.

ICP 12 was considered to be LO and the FSAP recommended that group-wide consolidated data for insurance groups be collected and of broader financial conglomerate groups introduced.

ICP 17 was considered to be partly observed (PO). The recommended action was that US supervisors should:

(i) include fuller assessment of the financial condition of the whole group of which a licensed insurance company is a member; this may involve quantitative techniques and practices in use internationally;

<p>(ii) extend the risk-focused approach to examinations of solo insurance companies to groups, again starting with U.S. groups—in effect extending the lead regulator and college of regulators arrangements already in widespread use for such groups within the framework developed by the NAIC;</p> <p>(iii) ensure that colleges of supervisors for the U.S. groups with major international operations are established and functioning effectively—and led by U.S. regulators with appropriate insurance expertise.</p> <p><i>It may also be desirable for insurance regulators to be given additional powers, such as clear authority to license insurance holding companies, apply insurance capital requirements to the consolidated insurance group and direct the insurance holding company to make changes at the group level to rectify any shortcomings.</i></p>	
<p>The DFA established a framework for policies and procedures for the regulation of systemically important institutions in the insurance sector through the ability of the FSOC to subject non-bank financial companies to prudential standards and consolidated supervision by the Fed.</p> <p>Section 113 of the DFA authorises the FSOC to subject a non-bank company to supervision by the Fed and prudential standards if the Council determines that:</p> <ul style="list-style-type: none"> i. Material financial distress at the non-bank financial company could pose a threat to US financial stability; or ii. The nature, scope, size, scale, concentration, interconnectedness or mix of the activities of the non-bank financial company could pose a threat to the financial stability of the US. <p>In order to be designated the company must have \$50 billion or more in total consolidated assets and meet at least one of the further 5 quantitative thresholds.⁶³ In addition, there is some discretion for the FIO to recommend to the FSOC that other companies, which are not covered under the quantitative criteria, be brought into the process.</p> <p>Consolidated supervision by the Fed will become applicable immediately upon formal designation. On 5 January 2012 a proposed rule on the enhanced prudential standards and early remediation requirements for covered companies (a company designated under Section 113 of the DFA is included in the definition of a covered company) was published. The proposed rule largely focuses on how prudential standards should be enhanced to cope with asset-related and banking-type risks. However, the DFA allows the Fed to tailor the enhanced prudential standards to reflect the business model, capital structure and risk profile of the designated company and the FIO has indicated that the development of specific measures for insurers is underway.</p> <p>Consolidated supervision continues to be carried out by the Fed of bank and saving and loan holding companies with insurance operations. There are now approximately 21 of these companies, though the number of companies has in fact declined with several groups choosing to sell their banking businesses in order to avoid consolidated supervision at the Federal level. The capital rules for these groups are in the process of being</p>	<p>FIO</p>

⁶³ See page 23 of the FSOC rule and guidance on the criteria for the designation of non-bank financial institutions (<http://www.treasury.gov/initiatives/fsoc/Documents/Nonbank%20Designations%20-%20Final%20Rule%20and%20Guidance.pdf>).

<p>revised as part of the US implementation of Basel III and due to legal requirements of the DFA. For this purpose, the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (Fed), and the Federal Deposit Insurance Corporation (FDIC) published three notices of proposed rulemaking (NPRs) in 2012.⁶⁴</p> <p>The NPRs would apply consolidated risk-based capital requirements that measure the credit and market risk of all assets owned by a depository institution holding company and its subsidiaries, including assets held by insurance companies. In addition, the US assert that the proposal would capture the risk of insurance underwriting activities included in the consolidated holding company capital requirements by requiring deduction of the minimum regulatory capital requirement of the relevant state regulator for insurance companies in the consolidated group.</p> <p>The FIO is responsible for monitoring “all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the US financial system”. This is done using publicly available data, although the FIO also has the legal authority to access non-public data.</p>	
<p>In 2010 the NAIC adopted changes to the Insurance Holding Company System Regulatory Act⁶⁵ and the Insurance Holding Company System Model Regulation with Reporting Forms and Instructions⁶⁶ (IHC Models). If adopted by the states, these changes would clarify the ability of state insurance commissioners to obtain the financial statements of an insurance holding company (IHC) and any affiliates within the holding company system. The revisions also would introduce the requirement for all groups to submit an Enterprise Risk Report (Form F) disclosing potential contagion or financial risks to the insurer. The revised IHC Models have resulted in the formation of international and regional colleges within the US. The NAIC Financial Regulation Standards and Accreditation (F) Committee is scheduled to vote on including the revisions in Accreditation to the IHC Models in Augusts 2013 and the NAIC Plenary vote is scheduled for December 2013. The revised standard will become effective two years after it is adopted. Thus far, the revised models have been adopted by 15 states.</p> <p>In 2012, the NAIC adopted the Risk Management and Own Risk Self-Assessment (ORSA) model. Under this model, to be implemented by 1 January 2015, all large groups will have to provide regulators with an internal assessment of the risk associated within its business and the sufficiency of its capital resources to support these risks. In April 2013, the model was recommended to the NAIC Financial Standards and Accreditation (F) Committee for Accreditation consideration. The ORSA report requires the insurance group to 1) summarize its risk management framework; 2) identify its material risks and the stress testing it performs on such risks, 3) discuss its internal group capital requirement in normal and stressed situations, the assumptions for both, and how the group monitors such capital levels. Iowa, Rhode Island and Vermont recently passed laws to implement the ORSA and similar measures are on the 2014 agendas of other state legislators.</p> <p>Since the last FSAP one lead supervisor has been assigned to each of the 320 US groups. The lead supervisor is responsible for coordination</p>	<p>NAIC/ States</p>

⁶⁴ Federal Register, Vol. 77, No. 169, Thursday, August 30, 2012.

⁶⁵ Model #440.

⁶⁶ Model #450.

<p>between the other supervisors and the group, as well as holding company analysis, identifying/ assessing corporate governance risks, considering market conducts risks, performing targeted on-site examinations and chairing the college. The criteria for determining the lead supervisor include the location of the group’s head office and the location of the most substantial insurance operations, although there is flexibility for states to agree a different lead supervisor where appropriate. State regulators and the NAIC have indicated that they are now more closely analysing the consolidated financial statements of the 15 US-based International Active Insurance Groups (IAIGs) as defined by the IAIS.</p> <p>The NAIC is considering a group capital assessment which would draw on the information received as part of the ORSA and other information available.</p>	
<p>FSAP Recommendation 3: Increase information sharing and coordination between state regulators and federal authorities, including through representation of state regulators in national bodies with responsibilities for system-wide oversight.</p> <p><i>This recommendation was assigned a medium priority and was to be completed in the medium term.</i></p> <p>Recommendations on Conditions for effective insurance supervision (ICP 1) and Supervisory cooperation and information sharing (ICP 5)</p> <p><i>ICP 1 was considered to be LO and the FSAP recommended that the authorities should (i) increase information-sharing and coordination between state regulators and federal authorities, including representation of state regulators in national bodies with responsibilities for system wide oversight and financial stability; (ii) agree policies and procedures for the regulation of systemically important institutions, markets and instruments, where assessed to exist in the insurance sector; and (iii) make new arrangements to increase the authority of federal authorities in relation to the implementation of international agreements.</i></p> <p><i>ICP 5 was considered to be LO and the FSAP recommended that the states and NAIC should continue to develop the network of MoUs. As mentioned in connection with ICP3, all state insurance departments should ensure that laws are updated to enable them to protect information received from foreign regulators. This will ensure that overseas regulators are not deterred from sharing information freely</i></p>	
<p>The FIO is responsible for coordinating federal efforts and developing federal policy on prudential aspects of international insurance matters. In this regard, the FIO regularly consults with other federal agencies involved in insurance-related issues in order to ensure better coordination between federal authorities. Regular contact between the FIO and the NAIC takes place via dedicated bilateral meetings, NAIC meetings, FOCI meetings and joint participation in international discussions of the IAIS. Some efforts are made to coordinate positions, though only the FIO (and not the NAIC) has the legal authority to represent the US.</p> <p>For the FSOC to determine that a nonbank financial company shall be subject to consolidated supervision by the Fed and enhanced prudential standards, as well as to designate a financial market utility or activity, the FSOC Chair must consent. The Director of the FIO is a non-voting member of the FSOC. A state insurance representative is also among the 5 non-voting members of the FSOC. It is noted that stages 2 and 3 of the designation process involves consultation with relevant state regulators.</p> <p>The FIO is able to collect information from insurers and their affiliates, but must first coordinate with other federal agencies and state regulators. The Treasury and the NAIC have entered into an MoU under which the FIO has access to a data portal which gives it access to non-confidential information. The FSOC has access to confidential information in relation to the groups that are being considered for designation for enhanced</p>	<p>FIO</p>

<p>supervision during stages 2 and 3 of the designation process.</p>	
<p>State regulators have a long history of cooperation and coordination between one another which is governed by the Master Information Sharing and Confidentiality Agreement, a nationwide information sharing and confidentiality agreement. In addition, the NAIC has coordinated 13 multilateral MoUs between third country jurisdictions and the US and this work is ongoing (a further 2 MMoUs are pending). Four MoUs have been signed since the FSAP with Taiwan, Bahrain, Curacao and Nigeria, as well as an extended MoU with China. Currently Connecticut, Washington State and Nebraska are signatories to the IAIS MMoU and a number of other states are in the pipeline.</p> <p>State regulators coordinate with the Fed in respect of the supervision of BHC and SLC with insurance operations that are subject to consolidated supervision and MoUs are in place between the Fed and each relevant state regulator. The NAIC recently hosted a meeting with the Fed to discuss group supervision and information sharing and state regulators can receive information obtained by the Fed during onsite examinations.</p> <p>FIO and the NAIC sit on the Financial and Banking Information Infrastructure Committee (FBIIC). This committee looks at infrastructure related issues such as how claims would be paid in the event of a man made or natural catastrophe.</p> <p>The NAIC provides FIO, through a data portal, access to information that would otherwise be available subject to a fee. In addition, FIO is able to access a variety of sources of non-public information. Also, the FSOC has access to non-public information in relation to nonbank financial companies being considered for designation.</p>	<p>NAIC/ States</p>
<p>FSAP Recommendation 4: Strengthen regulation of bond insurance and securities lending and modernize solvency requirements.</p> <p><i>This recommendation was assigned a medium priority and was to be completed in the medium term.</i></p> <p>Recommendations on Capital adequacy and solvency (ICP 23)</p> <p><i>ICP 23 was considered to be LO and the FSAP recommended that consideration be given to specifying a target safety level for reserving and an associated target safety level for capital. This should assist not only with peer comparisons of reserving and capital across insurers, but also comparisons against other insurance regimes internationally. Requirements to address inflation of capital through multiple gearing (i.e., holding company debt raisings injected as equity into insurance subsidiaries) should be included in the law, regulation or rules. Further development of stress testing could be considered, using the experience gained from exercises undertaken during the financial crisis</i></p>	
<p>The EU-US Dialogue Project agreed to further develop an approach to valuation which more accurately reflects the risk profile of companies, is sufficiently sensitive to changes in that risk profile and which has capital requirements that are fully risk-based, based on a clear and transparent calibration and that cover similar categories and subcategories of risks to which companies are exposed. In terms of timelines it has been indicated that the project shall be pursued over the next five years.</p>	<p>FIO/ NAIC/ States</p>
<p>Life insurers that engaged in securities lending business were negatively affected by illiquid markets during the financial crisis as a result of reinvesting cash collateral in illiquid instruments. The NAIC has put in place requirements to disclose information regarding securities lending, effective 31 December 2010. All insurers are required to disclose in Schedule DL the detail of “reinvested” collateral assets. For Schedule DL, “reinvested” collateral assets are collateral currently held as part of a securities lending program administered by the reporting entity or its agent</p>	<p>NAIC/ States</p>

(affiliated or unaffiliated) that can be resold or re-pledged. The NAIC also revised the Accounting guidance in 2010 for securities lending (reflected in SSAP No. 103 — Accounting for Transfers and Servicing of Financial Assets and extinguishments of Liabilities).

The market for bond issuance market has all but closed since the crisis. However, the US continues to monitor new business volumes and related underwriting considerations and underwriting results associated with old business.

The NAIC has adopted the Valuation Manual, which moves from formulaic rules to principle-based reserving (PBR) for life insurance products. The Valuation Manual begins the process of revising reserving requirements to be more dynamic to meet the needs for the variety of US life products and helps to mitigate the need for insurers to modify products in ways that circumvent formulaic regulatory requirements. PBR would replace the current formulaic approach to determining policy reserves with an approach that more closely calculates the risks of the highly complex products. The improved calculation is expected to reduce reserves that are too high for some products and increase reserves that are too low for other products; overall the total reserves would slightly decrease.

The Valuation Manual was adopted by a supermajority of NAIC members in December 2012, paving the way for states to begin adopting revisions to the SVL in their legislative sessions. Once at least 42 states (a supermajority) representing 75% of total US premium adopt the revisions to the SVL, PBR will be implemented. Future changes in the Valuation Manual require approval by a supermajority of NAIC jurisdictions. In conjunction with the implementation of PBR for life insurance products, the NAIC will be reviewing the relative impact to life risk-based capital levels and making adjustments, as needed.

Effective from 2012, liquidity risks need to be internally stress tested and companies may be requested to report the results of the stress tests to supervisors at any time. The information may be considered confidential and not captured within the statutory financial statements. The NAIC Financial Condition Examiners Handbook notes that requests for reporting entities to complete these templates may occur at any time and are not limited to instances of comprehensive statutory examinations.

With regard to stress testing, the SMI RBC (E) Subgroup recommended that stress testing be explored for both assessment and regulatory intervention purposes. State regulators have included stress testing on the working agenda of the NAIC's Capital Adequacy Task Force for 2013. Stress testing is anticipated to complement the stress testing that will be required in 2015 for ORSAs of larger insurers.

The NAIC SMI RBC (E) Subgroup has tentatively concluded that an overall safety level is not achievable because there is not sufficient data for every risk type, and is not necessary at this time given the relative role of RBC in the US solvency surveillance framework. The US has pointed to safety level targets for certain risk types; those safety level targets vary by risk class and are largely based on the estimated timing of failure by each risk type.

FSAP Recommendation 5: The NAIC and state legislatures should undertake reforms covering the terms of Commissioners' appointments, the rulemaking powers of state insurance departments, and their funding and staffing to bolster specialist skills

This recommendation was assigned a medium priority and was to be completed in the medium term.

Recommendations on Supervisory Authority (ICP 3)

<p><i>ICP 3 was considered to be PO and the FSAP recommended that the NAIC and state legislatures should make reforms including (i) providing for fixed terms to be standard for commissioner appointments, with dismissal mid-term to be possible only for prescribed causes and with publication of reasons; (ii) making departments fully self-funding, subject to continued accountability to and oversight by state legislatures, while allowing them greater flexibility to hire staff with specialist skills and reduce reliance on external experts; and (iii) extending the rule-making powers of departments to a wider range of technical issues (for example valuation and risk-based capital), and subject to appropriate consultation and requirements for due process.</i></p>	
<p>The Governance structures at insurance departments vary and the method of commissioner selection is determined by the legislature in each state. While in some cases the Commissioner is elected, in others he is appointed. There are explicit procedures for the appointment of commissioners. Only a minority are directly elected, the others are appointed by the state governor, with the advice and consent of the state senate. Appointed Commissioners generally hold office until the term of office of the appointing governor expires and can therefore be dismissed at any time.</p> <p>State insurance departments are dependent on state legislatures in respect of principal legislation and for budgetary resources, which cannot always be allocated according to the departments' own regulatory priorities (although income from examination work charged to companies can mitigate budgetary pressures). Departments are exposed to budgetary cuts during economic downturns, when workloads tend to rise.</p> <p>The NAIC will continue to provide the FSAP recommendation on commissioner selection as informal guidance to states contemplating changes in their processes and procedures for commissioner selection (as was done for New Mexico), but does not consider that the selection process impacts the effectiveness of the insurance department. The role of the Commissioner vis-à-vis others in the department involved in regulation and given the peer review system is also noted.</p> <p>The view of the NAIC on funding and staffing of state insurance departments is that states have resources with knowledge and experience, combined with the flexibility to contract for additional expertise and training to continuously upgrade their skills. States can supplement their internal resources and need for specialist skills by leveraging the centralized resources available at the NAIC. The accreditation standards include an expectation that departments have specialist resources. Departments are able to hire external experts and outsource work to supplement staff resources, where legislation specifically permits it—in particular to support examinations (the model law specifies a wide range of professional competencies).</p> <p>A regular staff exchange initiative has been introduced for states to assist each other with training for financial analysis and examinations.</p> <p>With respect to extending the rule-making powers of departments to a wider range of technical issues, it has been indicated that State Insurance</p>	<p>NAIC/ States</p>

<p>Commissioners currently have rule-making authority within the insurance code of their states.</p> <p>New Mexico recently signed into law legislation that makes the New Mexico Department of Insurance (NMDOI) a stand-alone agency, effective July 1, 2013⁶⁷. The NMDOI will be called the “Office of the Superintendent of Insurance.” The Superintendent will be selected by a bipartisan committee to serve a four-year term and can be removed only for incompetence or malfeasance.</p>	
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⁶⁷ The New Mexico Insurance Nominating Committee is charged with selecting the state's superintendent of insurance. The committee, which was created by Laws 2013, Chapter 74, consists of four members appointed by the governor, four members appointed by the New Mexico Legislative Council and a ninth member appointed by the eight committee members.

Annex 3: Follow-up actions by the US authorities on other key FSAP recommendations

This Annex presents the follow-up actions reported by the US authorities to key FSAP recommendations that are not covered in sections 2-4. The actions mentioned below have not been evaluated as part of the peer review and are presented solely for purposes of transparency and completeness.

FSAP recommendation	Action plan	Action timeline
<i>Redesign the regulatory architecture</i>		
Strengthen the Fed's role in consolidated regulation and supervision, including by enhancing coordination with bank and functional regulators and restricting deference requirements.	Fed will be the supervisor for firms designated for enhanced supervision, including nonbank financial companies. DFA requires that the Fed examine the activities of nonbank subsidiaries (that are not functionally regulated) of a BHC that are permissible for the company's subsidiary insured depository institutions in the same manner, subject to the same standards, and with the same frequency as if the activities were conducted in the company's lead insured depository institution subsidiary. In December 2012, the Fed issued a new framework for the consolidated supervision of large financial institutions, including bank holding companies (BHCs), foreign banking organisations (FBOs), savings and loan holding companies (SLHCs), and designated nonbank financial companies. The Fed continues to work with other regulators on implementation of this effort as well as other aspects such as Section 165 of the DFA.	The Fed's new consolidated supervision framework for large financial institutions is being implemented in a multi-stage approach. Additional supervisory and operational guidance is under development to support implementation of the framework and to assess the progress of firms in meeting these expectations. Fed staff is undertaking a broad review of fundamental objectives and approaches for the supervision of nondepository institutional subsidiaries extending beyond those areas directly addressed in DFA.
Unify safety-and-soundness regulation and supervision of commercial banks and thrifts in a single federal agency, and eliminate the federal thrift charter.	Although DFA preserves the thrift charter (Sections 311 and 312), the functions of the Office for Thrift Supervision (OTS) were transferred to the OCC, the FDIC, or the Fed, as appropriate, on July 21, 2011.	Complete
Unify federal securities and derivative market regulation into one federal agency.	N/A, but please note that the CFTC and SEC have increased coordination. Further, FSOC creates a forum for vetting a unified view on	N/A

	oversight of the markets.	
Establish an independent and accountable federal consumer protection agency, removing this responsibility from the other agencies to enhance their focus and effectiveness in their primary roles	In July 2011, regulatory authorities transferred to the Consumer Financial Protection Bureau (CFPB) certain enumerated federal laws and supervisory responsibility for large banks (over \$10 billion). This transfer was executed in collaboration with the CFPB, to ensure consistent and efficient supervision on jointly regulated institutions. Staffs have been transferred and protocols have been established to exchange information and coordinate simultaneous examinations.	Complete
<i>Strengthen micro-prudential regulation and supervision – Banking</i>		
Enhance the capacity for group-wide oversight of banking groups and conduct regular inter-agency horizontal assessments of complex groups (possibly by establishing domestic supervisory “colleges”).	To improve risk identification of both safety-and-soundness issues at individual institutions, and broader risks to the financial system both on an individual and collective basis, supervisory priorities and activities have taken on a more macroprudential orientation within the Fed. Furthermore, the banking agencies frequently conduct assessments across the largest firms as well as meet on a periodic basis with all regulators, including foreign counter-parts. The agencies have begun to conduct annual stress tests, as required by DFA.	The Fed set up the Large Institution Supervision Coordinating Committee (LISCC) to centralize the supervision of large banking firms and to conduct cross-firm analyses such as the Comprehensive Capital Analysis and Review (CCAR) of the largest US banking firms. Large bank supervision at the Fed will include more of these systematic, horizontal exercises. On October 9, 2012, the Fed issued two final rules on stress testing requirements for certain bank holding companies, state member banks, and savings and loan holding companies for which the Fed is the primary federal financial regulator. Nonbank financial companies designated by the FSOC will also be subject to certain stress testing requirements contained in the rules. These final rules revise portions of proposed stress testing requirements contained in the Fed’s proposed rule to implement enhanced prudential standards issued for comment on December 20, 2011. The Fed consulted with the FDIC and OCC to ensure consistency and comparability. (DFA Section 165(i)(1) and (i)(2)).

<p>Boost timeliness and forcefulness of supervisory and regulatory interventions to address weaknesses in enterprise-wide risk management practices.</p>	<p>DFA requires large BHCs and nonbank financial companies designated by the FSOC to be subject to early remediation requirements promulgated by the Fed. Since the crisis, the agencies have aggressively forced changes in bank and enterprise-wide risk management practices and in the strengthening of firm financial positions. Additionally, the agencies are in the process of enhancing standards for risk management, both through DFA and Basel III efforts.</p> <p>In addition, Treasury’s Office of Financial Research (OFR) has a responsibility to promote best practices for financial risk management and to evaluate and report on stress tests.</p>	<p>On December 20, 2011, the Fed requested comment on a proposed rule to implement requirements in Section 165 and 166 of DFA to establish stricter prudential standards for all BHCs with total consolidated assets of \$50 billion or more and any nonbank financial firms that may be designated systemically important companies by the FSOC. The comment period ended April 30, 2012. Comments are being analyzed and work on a final rule is under way.</p> <p>On December 14, 2012, the Fed requested comment on a proposed rule to implement requirements in Section 165 and 166 of DFA to establish stricter prudential standards for foreign banking organizations with total consolidated assets of \$50 billion or more and any foreign nonbank financial companies designated systemically important by the FSOC. The comment period ended on April 30, 2013.</p>
<p>Strengthen channels for cooperation, coordination, and learning from best practices—within and among the federal banking agencies, market regulators, and the states—to close regulatory gaps and prevent regulatory arbitrage, including with regard to charter conversions.</p>	<p>The Federal Financial Institutions Examination Council (FFIEC) Statement on Regulatory Conversions (July 2009) states that charter conversions or changes in primary federal regulator should only be conducted for legitimate business and strategic reasons. In addition, the DFA forbids charter conversions for institutions under a formal enforcement order or memorandum of understanding. A conversion can only be conducted with the cooperation and consent of the regulator that issued the order or memorandum of understanding.</p> <p>Within the context of the FFIEC and otherwise, the agencies meet periodically to discuss supervision at both an individual and cross-sector level. The interaction, both formal and informal,</p>	<p>On November 26, 2012, the banking agencies and the Conference of State Bank Supervisors issued an interagency statement regarding restrictions on charter conversions of troubled banks.</p> <p>On May 7, 2012 the Fed issued administrative guidance regarding the internal procedures for processing applications that are covered by section 612 of DFA, which places restrictions on conversions of troubled banks.</p>

	<p>between agencies has increased since the crisis. DFA addresses the shadow banking system in a number of ways (see sections on systemic companies and market utilities, derivatives and swaps, broker-dealers, securitizations etc.)</p> <p>In addition, OFR has a responsibility to monitor, investigate, and report on changes in system-wide risk levels and patterns to FSOC and Congress; and to conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets.</p>	
<i>Strengthen micro-prudential regulation and supervision – Securities and derivatives markets</i>		
<p>Enhance enforcement and oversight capacities and re-examine capital rules and other prudential requirements, such as risk management standards, to ensure that risks are fully addressed.</p>	<p>SEC Division of Enforcement has addressed and closed all 21 recommendations for enforcement program improvements arising from the SEC’s Office of Inspector General Madoff reports.</p> <p>The DFA requires the CFTC and SEC to prescribe (i) capital and margin requirements for swap dealers (“SDs”), security-based swap dealers (“SBSDs”), major swap participants (“MSPs”) and major security-based swap participants (“MSSPs”) that do not have a prudential regulator; (ii) segregation requirements for SDs, SBSDs, MSPs, and MSSPs; (iii) reporting and recordkeeping requirements for SDs, SBSDs, MSPs, and MSSPs; and (iv) rules with respect security-based swap clearing agencies.</p> <p>CFTC-registered central counterparties (“CCPs”), which are registered as DCOs, have been subject to statutory core principles since the 2000 amendments to the Commodity Exchange Act. The DFA amended and augmented these statutory provisions. There are now eighteen (18) statutory core principles for DCOs.</p> <p>The CFTC has finalized regulations to implement all of the core</p>	<p>SEC Enforcement: Complete</p> <p>The CFTC has finalized its regulations with regard to DCOs and proposed regulations with regard to capital and margin for uncleared swaps. The drafting of final rules is pending the completion of BCBS and IOSCO-led efforts on international coordination. Final rules are expected in the second half of 2013. The SEC proposed capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants and adopted a rule establishing risk management and operational standards for registered clearing agencies in 2012.</p>

	<p>principles, including risk management and financial resources requirements for DCOs. In addition, the CFTC has proposed capital and margin requirements for uncleared swaps for all swap dealers and major swap participants that will register with the CFTC and for which there is no prudential regulator.</p> <p>The SEC adopted rules for the operation of registered clearing agencies that take into consideration the CPSS-IOSCO standards for central counterparties and securities settlement systems, including rules that require clearing agencies that provide CCP services to maintain certain risk management practices, including practices related to measurement and management of credit exposures, margin requirements, financial resources, and annual evaluations of the performance of margin models.</p>	
<p>Implement the recommendations of the Joint Report to enhance investor protection and improve cooperation between the CFTC and SEC; close legislative and regulatory gaps identified in the Joint Report.</p>	<p>The CFTC and SEC staff continue to work together to help advance the implementation of the Joint Report's recommendations. The DFA provides for enhanced cooperation between the SEC and the CFTC in a number of areas and addresses all of the Joint Report's recommendations for legislative change except with regard to the establishment of the Joint Advisory Committee, which was authorized by Congress in legislation separate from the DFA. The Joint Report identified that the lack of CFTC or SEC authority over OTC derivatives resulted in significant regulatory gaps. The new authority provided to the CFTC and SEC in the DFA addresses such regulatory gaps. Our current efforts to reduce or close identified gaps are dominated by the required rulemakings under the DFA.</p> <p>Additionally, the CFTC and SEC have been holding regular conference calls and meetings with foreign market regulators to coordinate on OTC derivatives market regulation relating to standardization, central clearing, exchange or electronic platform trading and capital and margin requirements.</p>	<p>Ongoing</p> <p>SEC and CFTC: Implementation of this recommendation is underway. For example, with respect to the DFA, the CFTC and SEC have now finalized joint rulemakings, including, most recently two sets of joint rules further defining key entity product and terms used in the DFA such as a swap”, “security-based swap”, “security-based swap agreement”, “mixed-swap”, “swap dealer”, “security-based swap dealer”, “major swap participant” and “major security-based swap participant”. The CFTC and SEC also jointly prepared a study of International Swap Regulation that was submitted to Congress.</p>

<p>Complete the consolidation of equity and equity option market surveillance into a single entity taking into account issues of dark pools, high frequency trading, predatory algorithms, and other technology based practices.</p>	<p>The SEC adopted rules to establish a consolidated audit trail that would collect and report customer and order event information for all orders across all markets -- including dark pools -- to a central repository, thus creating a single database of comprehensive and readily accessible audit trail data that will be available for regulatory purposes, including surveillance of high frequency trading, predatory algorithms and other technology based practices.</p> <p>The SEC adopted a new rule in 2011 to establish large trader reporting requirements in order to enhance the agency's ability to identify large market participants, collect information on their trading, and analyze their trading activity. This large trader reporting rule should help the SEC to identify market participants engaged in substantial trading activity, obtain information needed to monitor more efficiently the impact of those trades on the markets, and analyze such market participants' trading activity.</p>	<p>For the consolidated audit trail, the Exchanges and FINRA are to submit an NMS plan to the Commission by December 6, 2013, and are to provide to the central repository the required data within one year after effectiveness of the national market system (NMS) plan. Members of the Exchanges and FINRA are to provide to the central repository the required data within two years after effectiveness of the NMS plan and the NMS plan may provide small broker-dealers up to three years after effectiveness of the NMS plan to the central repository the required data.</p> <p>The first phase of the broker-dealer recordkeeping and reporting requirements under the large trader rule were implemented on November 30, 2012 and apply to trading by US-registered broker-dealers as well as trading through sponsored access arrangements. The compliance date for the remaining large trader recordkeeping, reporting and monitoring requirements is currently November 1, 2013.</p>
<p>Promote standardization of OTC derivatives in order to increase market reliance on exchange trading and multilateral clearing and require proper collateralization of all derivative transactions, whether held at a clearinghouse or bilaterally.</p>	<p>Title VII of the DFA contains a number of provisions that provide the CFTC and SEC with authority to regulate the OTC derivatives market consistent with the recommendations relating to standardization, central clearing, exchange or electronic platform trading, and capital and margin requirements. The CFTC has implemented a number of rules that relate to standardization and central clearing. The CFTC has proposed rules for margining uncleared swaps entered into by swap dealers and major swap participants. The SEC is currently in the process of proposing finalized rules to implement these and other provisions in the DFA. In addition, the CFTC and SEC participate in the OTC Derivatives Supervisors Group, which</p>	<p>The CFTC and SEC have proposed and adopted applicable rules since the passage of the DFA in July 2010. On November 29, 2012, the CFTC adopted its first clearing requirement determination, requiring that swaps meeting the specifications outlined in four classes of interest rate swaps and two classes of credit default swaps are required to be cleared. The CFTC also has adopted rules providing that when counterparties submit their swaps for clearing, the rules of the derivatives clearing organization, rather than the original bilateral contract terms, govern that</p>

	<p>continues to work with major market participants to increase standardization of OTC derivatives and processes. The CFTC and SEC serve as co-chairs of the IOSCO OTC Task Force, which has prepared papers on mandatory clearing, trade execution, derivatives markets' intermediaries and data aggregation (the last in conjunction with CPSS). In addition, the CFTC and SEC participate in a multilateral group of the leaders of authorities with responsibility for the regulation of OTC derivatives markets (Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Canada, Quebec, Canada, Singapore, Switzerland and the US) which last met on 20 June 2013. Finally, both the CFTC and SEC participate in the FSB OTC Derivatives Working Group which tracks and reports progress made by jurisdictions in achieving the G20 mandate with regard to OTC derivatives reform.</p>	<p>cleared swap. The CFTC has adopted rules that provide for straight-through processing of swaps and timely acceptance of swaps for clearing. In addition, the CFTC has implemented timely confirmation rules for swaps entered into by swap dealers and major swap participants. Such timely post-execution processing requirements along with increased clearing and simplified documentation necessitate, and thereby promote, standardization of OTC derivatives.</p> <p>As noted in item 17, the SEC proposed capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants and adopted a rule establishing risk management and operational standards for registered clearing agencies in 2012. In addition, in 2011 the SEC proposed a rule for security-based swap dealers and major security-based swap participants to provide a trade acknowledgment to a counterparty in a security-based swap transaction within 15 minutes, 30 minutes, or 24 hours of execution, depending on whether the transaction is executed or processed electronically.</p>
<p>Improve transparency of OTC derivative and securities markets by requiring timely reporting of transactions and providing better information to investors.</p>	<p>Pursuant to the DFA, the CFTC has finalized and the SEC has proposed rules which require the reporting of swap and security-based swap information to registered data repositories or to the CFTC or SEC (if no data repository is available) and the public dissemination of swap and security-based swap transaction, volume, and pricing data.</p> <p>OFR is focused on working through the OTC Derivatives Regulators Forum, and other international regulators forum, to support robust trade and clearing repositories data collection, use of data standards and standardization to provide better</p>	<p>Complete: CFTC</p> <p>The SEC proposed rules for the reporting and dissemination of security-based swap information and for the registration, duties, and core principles of security-based swap data repositories.</p>

	information to investors for ease of aggregation, comparison and analytics, and to obtain appropriate access to the data on behalf of FSOC for monitoring and analyzing national and global systemic financial risk.	
<i>Strengthen micro-prudential regulation and supervision – Shadow banking and other short-term funding markets</i>		
Discourage the use of deposit-like instruments outside the formal banking sector and ensure appropriate liquidity management by sectors potentially falling within the systemic liquidity safety net.	Through DFA and Basel III, liquidity management will be enhanced, and nonbank financial companies designated by the FSOC will be subject to the enhanced liquidity standards required by DFA Section 165.	
Set minimum haircuts for repurchase agreement transactions and address incentives for the repo clearing banks to extend intraday credit in the clearing and settlement cycle.	With the active encouragement of supervisors and regulators, substantial progress has been made by the industry with respect to reducing discretionary extension of credit by clearing banks in the tri-party settlement process, a key financial stability concern. Reliance on such credit has fallen by about 20% through the first quarter 2013. Current timelines project an 80% reduction in intraday credit extension to dealers by January 1, 2014 with additional efforts in 2014 reducing the credit to the targeted 90% reduction by year-end. See http://www.newyorkfed.org/banking/tpr_infr_reform.html .	Ongoing
Require money market funds to make real-time disclosures of their actual (as opposed to “stabilized”) net asset values.	SEC and FSOC are considering possible additional money market fund regulatory reform.	FSOC issued proposed recommendations in November 2012. The comment period on these recommendations ended February 2013.
<i>Strengthen oversight of market infrastructure</i>		
The Fed should continue to assess payment, clearing, and settlement infrastructures for their ability to cope with extreme liquidity stress and explore the introduction of a	The assessment of liquidity risk management by systemically important FMUs is a key supervisory priority of the Fed. The US agencies have promulgated liquidity risk-management standards applicable to the FMUs. Furthermore, these FMUs are subject to examination at least annually by their Supervisory Agency. In	Ongoing

<p>queuing and offsetting mechanism in the <i>Fedwire Funds Service</i> similar to those in other G10 countries' large value payment systems.</p>	<p>planning for such examinations, the relevant Supervisory Agency consults with the Fed regarding examination scope and methodology. Finally, any change to a designated FMU's rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated FMU, such as liquidity risk, must go through ex ante regulatory review process. Fed staff engages with staff from other agencies on a routine basis to implement these provisions.</p> <p>A queuing and offsetting mechanism is not currently being explored. The Fed recently implemented changes to its Policy on Payment System Risk to provide more flexibility in the manner in which it offers intraday credit and to incent collateralization. The low demand for intraday credit during this period of high overnight balances and the elimination of fees for collateralized daylight overdrafts has diminished institution interest in this feature at this time. Additionally, the Fedwire Funds Service is wrapping up a technology migration currently.</p>	
<p><i>Enhance crisis management, resolution, and systemic liquidity arrangements</i></p>		
<p>Extend the special powers of the FDIC to enable receivership or conservatorship of BHCs and systemically important financial firms.</p>	<p>The FDIC has adopted rules and regulations to implement the Orderly Liquidation Authority (OLA) under Title II of the DFA, which enable the FDIC (under circumstances specifically enumerated within the DFA) to place systemically important financial firms into receivership if necessary and appropriate. The FDIC also established an Office of Complex Financial Institutions, which has primary responsibility for implementing the OLA.</p>	<p>Initial rulemaking has been completed; additional rulemaking is ongoing.</p>
<p>Review the funding arrangements for the Deposit Insurance Fund by removing the ceiling on the size of the fund and increasing its size. One response would be to increase the targeted ratio of reserves in the</p>	<p>The DFA raised the minimum reserve ratio from 1.15% to 1.35%. The FDIC has adopted a Deposit Insurance Fund ("DIF") Restoration Plan, under which the DIF reserve ratio is projected to reach 1.35% by September 30, 2020. The DFA also eliminated the ceiling of 1.50% (DFA gave FDIC sole discretion on whether to issue dividends back to the banks once the fund</p>	<p>Complete</p>

fund to insured deposits.	reaches 1.50%).	
Implement “living wills” requirements for large and complex financial groups, and address group structures that appear likely to severely impede effective resolution.	<p>On November 1, 2011, the Fed and the FDIC jointly published a final rule (effective November 30, 2011) in the Federal Register to implement section 165(d) of the DFA that requires bank holding companies with \$50 billion or more in total assets and non-bank financial companies designated for enhanced prudential supervision to submit resolution plans (often referred to as “living wills”) to provide for their resolution under the Bankruptcy Code. The first resolution plans were due July 1, 2012.</p> <p>In addition, on January 23, 2012, the FDIC published a final rule requiring insured depository institutions with \$50 billion or more in total assets to submit to the FDIC periodic contingency plans for resolution in the event of failure.</p>	<p>Ongoing: Final rule was published on November 1, 2011. Nine covered companies filed their first group of resolution plans and certain of their affiliates also filed plans under the FDI Act in July 2012. Two covered companies filed their initial resolution plans in October 2012. An additional four covered companies filed their initial resolution plans and certain of their affiliates also filed FDIC Act plans in July of 2013. The second round of resolution plans from the July 2012 and October 2012 filers is expected in October 2013. Initial resolution plans are expected from the third wave of covered companies on or before December 2013.</p>
Consider widening the range of counterparties and collateral used for open market operations (OMO) and articulating policies for future Fed lending to nonbank financial firms to enhance the scope and predictability of systemic liquidity provision.	<p>Since 1999, the Fed has been able to conduct tri-party repos using Treasuries, agency mortgage-backed security (MBS), and agency debt as collateral. In 2010, the Fed established the capability to conduct reverse repos in tri-party with all eligible OMO collateral. In addition, the Fed continues to expand the list of counterparties eligible to participate in reverse repo operations (e.g. money market funds, government-sponsored enterprises or GSEs, and banks and savings associations). The Fed has also created the reserve-draining Term Deposit Facility, which allows any depository institution to bid at auction for specified term deposits, which would be funded by regular reserve balances. Operational readiness is being maintained for the reserve-adding Term Auction Facility, which allows all depository institutions in generally sound financial condition to bid at auction for discount window loans of pre-determined tenors.</p>	
<i>Address too-big-to-fail issues and the future of the GSEs</i>		

<p>Discourage size and complexity by subjecting systemic financial institutions to more stringent prudential requirements.</p> <p>Action will be appropriate on multiple fronts: prudential norms, systemic risk charges, narrow banking/size limitation, compensation/ governance, prompt corrective action, living wills</p>	<p>The Fed drafted proposed enhanced prudential standards for large banking organizations and nonbank financial companies designated by the FSOC in consultation with other banking agencies. These standards include enhanced risk-based capital and leverage requirements, liquidity requirements, and single-counterparty credit limits. The DFA also directs the Fed to conduct annual stress tests of large banking firms and designated nonbank financial companies and to publish a summary of the results. On November 1, 2011, the Fed and the FDIC jointly published a final rule to implement section 165(d) of the DFA regarding resolution plans (i.e., “living wills”).</p>	<p>On December 14, 2012, the Fed issued a proposed rule to strengthen the oversight of US operations of foreign banks. In addition, on December 20, 2011, the Fed requested comment on a proposed rule to implement requirements in Section 165 and 166 of the DFA to establish stricter prudential standards for all BHCs with total consolidated assets of \$50 billion or more and any nonbank financial firms that may be designated systemically important companies by the FSOC. The comment period ended April 30 2013. Comments are being analysed and work on a final rule is under way.</p> <p>On December 14, 2012, the Fed requested comment on a proposed rule to implement requirements in Section 165 and 166 of DFA to establish stricter prudential standards for foreign banking organizations with total consolidated assets of \$50 billion or more and any foreign nonbank financial companies designated systemically important by the FSOC. The comment period ended on April 30, 2013.</p>
<p>Provide regulators the authority to take pre-emptive actions when vulnerabilities build at potentially systemic financial firms.</p>	<p>See recommendation to boost timeliness and forcefulness of supervisory and regulatory interventions to address weaknesses in enterprise-wide risk management practices.</p>	
<p>Reform the housing GSEs, possibly by privatizing their retained asset portfolios and re-assigning responsibilities for social objectives / system support to an explicitly guaranteed public utility.</p>	<p>Actions to date: various congressional bills, Administration white paper, FHFA/Housing and Urban Development Department servicer compensation project, FHFA/GSE servicer rules alignment, Uniform Mortgage Data Project, scheduled decrease in loan limits, guarantee fee increases, actual and scheduled decreases in GSE retained portfolios, redesign of GSE</p>	<p>TBD</p>

	<p>housing goals, tightened underwriting standards and greater use of risk-based pricing, review of further changes in similar direction as well as greater GSE risk-sharing. During the past year, GSE guarantee fees were raised by one-third and substantial progress was made on the Data project and reductions in the retained portfolios. FHFA also released a strategic plan for the GSE conservatorships that includes the development of a new securitization platform to create future back-office infrastructure and standardized pooling and servicing agreements, as well continued focus on GSE risk-sharing. FHFA, working with the Treasury, has pushed the GSEs into the development of securities issues that would shed new mortgage credit risk to investors. Similar plans are under way for shedding risk through sound mortgage insurers.</p>	
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