Domestic Systemically Important Insurers

Why in News

The **Life Insurance Corporation of India** (LIC), **General Insurance Corporation of India** and The **New India Assurance Co** have been identified as **Domestic Systemically Important Insurers (D-SIIs) for 2020-21** by insurance regulator, the Insurance Regulatory and Development Authority of India (IRDAI).

- The IRDAI would identify D-SIIs on an **annual basis** and disclose the names of such insurers for public information

Key Points

- **Requirements for D-SIIs:**
    - The three public sector insurers have been asked to raise the level of corporate governance.
    - Identify all relevant risks and promote a sound risk management culture.
    - The D-SIIs will also be subjected to enhanced regulatory supervision of the IRDAI.
- **Domestic Systemically Important Insurers:**
    - D-SIIs are perceived as insurers that are **'too big or too important to fail' (TBTF)**.
    - D-SIIs refer to insurers of such size, market importance and domestic and global interconnectedness whose distress or failure would cause a significant dislocation in the domestic financial system.
    - Thus, the continued functioning of D-SIIs is critical for the uninterrupted availability of insurance services to the national economy.
- **Reasons:**
    - The insurance sector had grown exponentially in the last 15 years and a few of the insurers have a sizeable market share and interconnected with other financial institutions as well.
    - With perception of TBTF and the perceived expectation of government support may amplify risk taking, reduce market discipline, create competitive distortions, and increase the possibility of distress in future.
- **Concerns:**
    - Given the nature of operations and their systemic importance, the failure of D-SIIs has the potential to cause significant disruption to the essential services they provide to the policyholders and, in turn, to the overall economic activity of the country
    - These considerations require that D-SIIs should be subjected to **additional regulatory measures** to deal with the **systemic risks** and **moral hazard** issues.
        - **Systemic risk** is the possibility that an event at the company level could trigger severe instability or collapse an entire industry or economy.
        - **Moral hazard** is a situation in which one party gets involved in a risky event knowing that it is protected against the risk and the other party will incur the cost. It arises when both the parties have incomplete information about each other.

- **Background:**
    - In January 2019, IRDAI announced the formation of a committee on D-SIIs.
    - The constitution of the committee came in the backdrop of the **International Association of Insurance Supervisors (IAIS)** asking all member countries to have a regulatory framework to deal with Domestic-SIIs.
        - The **IAIS** is a voluntary membership organization of insurance supervisors from over 200 jurisdictions, constituting 97% of the world's insurance premiums. It is the international standards-setting body for the insurance sector.

Domestic Systemically Important Bank (D-SIBs)

- D-SIB means that the bank is too big to fail. According to the **Reserve Bank of India (RBI)**, some banks become systemically important due to their size, cross-jurisdictional activities, complexity and lack of substitute and interconnection. Banks whose assets exceed 2% of GDP are considered part of this group.
- Presently, the State Bank of India (SBI), ICICI Bank, and HDFC Bank have been identified as DSIBs in India.
- **Significance:**
    - Should such a bank fail, there would be significant disruption to the essential services they provide to the banking system and the overall economy.
    - The **too-big-to-fail** tag also indicates that in case of distress, the government is expected to support these banks.
    - Due to this perception, these banks enjoy certain advantages in funding. It also means that these banks have a different set of policy measures regarding systemic risks and moral hazard issues.

Source: TH