redefining / standards

**Christian Thimann**
*Member of the Executive Committee*

Tel.: +33 1 40 75 71 25
christian.thimann@axa.com

Mr Sven Andresen
Secretary General
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

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**Re: FSB consultation on Recovery and Resolution Planning for Systemically Important Insurers: Guidance in Identification of Critical Functions and Critical Shared Services, 16 October 2014**

Dear Svein,

We would like to respond to the FSB consultation on critical functions in insurance, highlighting the following points that are elaborated in the attached document:

1. **It is important not to confuse the concepts of what is 'critical' and what is 'systemic'.** We understand criticality as linked to specific functions, performed on a given domestic insurance market and analysed in the context of their discontinuation. Systemicity is linked to institutions, acting in a global financial system and analysed looking at their on-going activities. With these definitions, the FSB frameworks should distinguish as much as possible critical functions from systemically relevant events (system-to-firm) or systemically risky activities (firm-to-system). In light of this, the two concepts of criticality and systemicity are neither interchangeable nor substitutable in the different regulatory exercises and frameworks.

2. **The time dimension is not yet sufficiently specified in the identification of critical functions as proposed in the consultation document.** Specifically, functions should be seen as 'critical' only if their suspension would lead to an *imminent* impact on financial stability and the functioning of the real economy. This would not be the case, for example, with the suspension of certain life insurance underwriting of new contracts, even if an insurance company might have a dominant role in a domestic market reflected in the size of its inforce portfolio. Although such underwriting might be important for the long-term development of that market, there would be no imminent impact on financial stability or the real economy, and hence these functions should not be seen as critical. More broadly, as is well known, failures of insurance companies are drawn-out processes that can last decades due to the long-term nature of insurance liabilities. Therefore, the substitutability assessment should be done taking account of the additional time that insurance companies and supervisors might have to prepare and coordinate proper responses if signs of financial strain are detected.

3. **In order to be coherent with the overall FSB/IAIS framework, the relevance of identification of critical functions should be limited to the design of the Recovery and Resolution Plans.** It should not lead to a renewed set of functional identification that would represent a further layer of measures and blur the framework presented so far.

I would be pleased if you could still consider this submission even though the formal submission date has passed. If your colleagues have further questions on this submission, they are welcome to contact Amélie de Montchalin (amelie.demontchalin@axa.com) and Jean-Damien Létoquart (jeandamien.letoquart@axa.com) at the AXA Group headquarters in Paris.

With best regards,

Chr. Thimann

**AXA Contribution to the FSB Consultation on Recovery and Resolution Planning for Systemically Important Insurers: Guidance in Identification of Critical Functions and Critical Shared Services, 16 October 2014**

1. It would be useful to **clarify the context and outcome of the consultation**: is the reflection aimed at 'ensuring an orderly resolution with reduced risks of systemic disruption and preservation of value' on domestic markets? Or will it feed a broader understanding of the macroeconomic role of insurers, independent from the context of a company's failure? **In any case, it should not explicitly refer only to G-SIIs but to all firms operating in a domestic market.**

2. The context and outcome of the consultation should be strictly framed: practical consequences of critical functions identification should be **limited to Resolution Plans.** It should not lead to a renewed set of functional identification that would impose yet another layer of interventions and blur the framework presented so far. And it should not interfere in the normal course of companies' operational management or encourage intrusive supervision of pure business decisions. Critical functions identification is mainly a tool for supervisors in the light of resolution, rather than a managerial tool for companies.

3. The proposed definition of a critical function frames it as 'a function which "sudden" disruption or failure to be provided by an insurer would have material impact on the financial system and the real economy (because of poor substitutability and major importance/relevance for the real economy)'.

   **We propose an alternative definition**: '*To be considered as critical, a function, if suddenly suspended, should adversely and imminently affect the real economy and impact financial stability*'.

   With this definition and the proposed three-step method framed in the consultation, the **number of functions per firm in a given market is not likely to be large**.

4. In the identification process, **critical functions are not deemed equivalent to systemically relevant events (system-to-firm) or systemically risky activities (firm-to-system)**.

5. **The core features of the insurance business model should be duly reflected in the identification of critical functions. Insurance companies do not 'fail' suddenly** and assets and capital already exist to meet current and future liabilities:
   - The assets do not disappear suddenly. Run-offs or portfolios transfers are the normal way to wind-up operations in an orderly way.
   - The key role of regulators is to protect insurers from the potentially irrational herd behaviour of policyholders.
   - No mass lapse or surrender and no liquidity runs were observed in the insurance sector, as evidence reported in previous Geneva Association studies shows, including case studies of Equitable Life UK, HIH and Ethias (see Geneva Association 2010 reports on systemic risk).
   - The effects of insurance guarantee schemes should be taken into account.

⇨ At most, a 'failed' insurer stops underwriting new business. We understand this latter point to be where the consultation tries to focus – as highlighted in our proposed definition focusing on 'suspension' of functions.

**Disruption does not mean failure**. Many historical examples of 'disruption' were linked to external events that changed the pricing methods and policyholders' behaviour, and cannot be included *ex ante* in Resolution Plans.

- The events of 11 September 2011 in the U.S. led to prohibitively expensive aviation insurance before returning to normal.
- New jurisprudence in French courts in the 1990s led to increasingly expensive premiums for medical professions, especially obstetricians, and temporary lack of insurance coverage – but babies continued to be born.
- The continuing decline in interest rates in Japan in the late 1990s was the result, inter alia, of monetary policy and deflationary pressures, to which life insurance companies adapted over time.
- The sudden increase in interest rates in Korea in 1997-1998 was a consequence of the Asian financial crisis, which affected many more sectors than insurance.

⇨ These examples of disruptions are linked to the regulatory and economic environment rather than to the internal solvency and risk management of insurance companies. They have little relevance for the design of Resolution Plans.

6. Critical functions should be **defined at the firm level** as **those with low external substitutability:**
    - **Substitutability** needs to be addressed looking in detail at:
        - *Ex ante* standardisation of products and pricing methods.
        - *Ex post* exchange/trade of public data/clients across firms.
        - The normative and effective roles of regulation during times of crisis.

    - The **conditions** of substitutability need more refinement:
        - 'Reasonable **timing**' for substitutability is a more relevant issue for banks than insurers, as market and regulators have plenty of time to restructure in an orderly way.
        - The consultation asks a problematic question: 'Are the **pricing** levels, attachment points, and terms and conditions provided by the failing firm available?' Prices in insurance are driven by market forces and actuarial analysis, and in most cases, they are not regulated in market economies.

7. **The impact on the real economy needs better research, conceptual grounding and practical guidance**, based on quantitative elements and historical analysis:
    - There are very few examples in the research literature of cases of insurance failure having consequences for the real economy.
    - There is a clear need for indicative metrics and thresholds to determine what is considered to be a significant impact on the real economy, to guide the work of insurers and supervisors.
    - Why is the focus on insurance and not other sectors? For example, globalised production chains pose the same type of issues (Fukushima tsunami led to lack of inputs for car manufacturers in Europe).

- Is insurance at the same level of importance as, for example, hospitals, pharmacists and fire services, where continuity plans are critical? In what dimensions is it comparable to banks (while protecting the payment function, deposit guarantee are capped)?
- A possible scenario of contagion and panic stemming from an insurance company failure would need analysis and evidence. So far, it is purely hypothetical and cannot be the basis for policy measures.