



Institute  
and Faculty  
of Actuaries

# Developing Effective Strategies and Plans for Systemically Important Insurers

IFoA response to the Financial Stability Board

04 January 2016

## **About the Institute and Faculty of Actuaries**

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



Financial Stability Board  
Bank for International Settlements  
Centralbahnplatz 2  
CH-4002 Basel  
Switzerland

4 January 2016

Dear Sirs,

### **Developing Effective Strategies and Plans for Systemically Important Insurers**

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Financial Stability Board on the Consultative Document on Developing Effective Strategies and Plans for Systemically Important Insurers.

The IFoA has a Working Party which is focused on Recovery and Resolution Planning and includes actuaries working across life and general insurance, for firms, consultancies and regulators. They have between them many years of experience in working with firms who have either prepared resolution plans or been considering similar issues in the context of stress and scenario planning exercise, including reverse stress testing. The Working Party has also consulted individuals who have experience of working with firms which have been through actual resolution or 'near-resolution' scenarios in recent years to understand better the practical issues involved.

1. In our view the FSB's draft guidance within the consultation paper is well-written and gives comprehensive guidance to the key issues involved. In response to the specific questions:

**Question 1: Do you agree that authorities should identify institution-specific resolution objectives as proposed in Section I? Are there any considerations relevant to that identification, additional to those discussed in this document that should be covered in the Guidance?**

2. One area in which we think the objectives and implications are not clear is reinsurance. A stated objective is 'to fullest extent possible, protecting policyholders when an insurer fails'; but does this objective include reinsurance policies? There are issues around the impact on some third-party policyholders either directly or through effects on the solvency of their insurer from the failure of reinsurance policies (which can be issued primarily by direct insurers as well as pure reinsurers). This follows given the ranking of reinsurance policies in an insolvency in some jurisdictions, and the interaction with 'no creditor worse off in insolvency' if reinsurance is to be protected in some way.
3. Paragraph III 1. C of the consultation paper explains that 'the interconnectedness associated with reinsurance is in principle contingent in nature'. This seems to overlook the implications of reinsurance failure on, for example, the large volumes of reinsurance associated with unit-linked investment funds. In our view, therefore, the issue of the treatment of reinsurance policies and their priority in a failure should be considered further.

4. One other aspect which could be given more attention is that institution-specific resolution objectives are sensible given the diversity of the market participants. For example, objectives could take account of the dominance of a specific firm in a particular market. However, some consistency of objectives would be expected at the level of specific market activities and regulators are well-positioned to develop these given their market-wide view.

**Question 2: Are the considerations for determining ‘points of entry into resolution’ as discussed in Section I.1 appropriate and relevant for the insurance sector?**

5. We believe there could be some additional commentary for those insurance groups which provide a range of financial services - such as retail banking, asset management, administration services, insurance and trustee services - and how resolution might be considered in such groups.

**Question 3: Do you agree with the considerations in Section II and underlying analysis in Section III for determining a preferred resolution strategy? Are there other relevant factors that should be taken into account?**

6. In Section II it is stated that ‘the required capital levels set by the authorities are likely to be lower than would be necessary for it to write new business’. However, defining the level of capital required in run-off in practice may be challenging:
  - a) How to determine what that lower level might be?
  - b) If that level were above the available excess of assets over liabilities, who provides the capital?
  - c) How does any policyholder compensation scheme fit into this – e.g. paying out less than 100% on claims early on to avoid calls on capital later?
7. One approach might be to reassess capital requirements under the new circumstances and for any deficit to be applied to all claims on a pro-rata basis, but with the deficit reviewed periodically. Should the deficit reduce then claims, both paid and future could then be increased accordingly.
8. In Section III 1. a, we note that entering administration may also trigger contractual rights for policyholders (such as certain trustee policies or reinsurance), as well as on derivative contracts.

**Question 4: Are the resolution tools that are described in Section II.2 appropriate for use in a resolution of an insurer? Should other tools be considered?**

9. We believe more consideration should be given to how bail-in works for insurers in relation to policyholders, both with profit and non-profit. Different regulators will have different powers to make alterations to contracts of insurance so the feasibility of this as a tool will vary from jurisdiction to jurisdiction. Different considerations may also arise if less than 100% of claims are paid initially.

**Question 5: Is the proposed framework for developing effective resolution strategies and plans for systemically important insurers flexible enough to take due account of the different types of business undertaken by systemically important insurers?**

10. In our experience, it may be necessary to consider how to deal with (potentially onerous) options on life policies if they are material.

**Question 6: Is the proposed approach for identifying (i) critical functions (Section III.2) and critical shared services (Section III.3) appropriate and relevant for supporting the development of effective resolution strategies and plans for systemically important insurers? If not, what aspects, if any, are missing or need to be changed?**

11. In section III 2. c, part (ii), we would suggest that 'avoiding termination' would be better than 'preventing termination'. In part (iii), there is no apparent reason to qualify payments falling due by adding 'in particular where those payments are not contingent on an event taking place after commencement of resolution'. We would also suggest adding a section (iv) 'the payment of claims incurred before commencement of resolution but not yet paid' (and perhaps moving it to (ii)).
12. In Section III 3. a. 'Identification of critical shared services' is not clear where the collection of future premiums is undertaken automatically by banks directly from the policyholders' bank accounts ('Direct Debit'). Direct Debits are a highly critical function for continuity of insurance and worthy of specific consideration.
13. In our view, 'substitutability' of critical functions is an important consideration but we think this needs expanding a little as it does not adequately address the costs involved. There may be substitutability but only if a significant increase in price is paid to an alternative provider. The penultimate paragraph before Box 1 recognises that insurers can offer different services but then says nothing further. We think that this paragraph should be expanded to describe the extent to which matters can be identified as critical activities, or otherwise be removed. We note that Box 1 is a helpful checklist.

**Question 7: Are there arrangements, in addition to those set out in Section IV of the draft Guidance, that may be needed to ensure that a resolution strategy for an insurer can be implemented and that should be covered by this guidance?**

14. We have no other arrangements to add.

**Question 8: Are there any other issues in relation to resolution strategies and tools or the resolution of insurers generally that it would be helpful for the FSB to clarify in further guidance?**

15. We have no other issues to add.

Should you wish to discuss any of the points raised in further detail please contact Steven Graham, Technical Policy Manager ([steven.graham@actuaries.org.uk](mailto:steven.graham@actuaries.org.uk) / 0207 632 2146) in the first instance.

Yours sincerely,



Nick Dexter

**Chair, Recovery and Resolution Working Party  
Institute and Faculty of Actuaries**