Position Paper

Insurance Europe response to FSB Consultation on critical functions

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General comments

Insurance Europe welcomes the opportunity to respond to this consultation by the FSB on the identification of critical functions and critical shared services in the context of recovery and resolution planning for systemically important insurers.

Insurance Europe supports the FSB's encouragement of cross-border supervisory co-operation on resolution and its efforts to develop a common understanding of critical functions. Insurance Europe believes that a transparent supervisory approach based on international standards is needed for the identification of critical functions and critical shared services. Insurance Europe would highlight though that when applying a common understanding of critical functions, the differences between various business models should be taken into account.

Insurance Europe welcomes the recognition by the FSB that critical functions would differ according to jurisdiction and to particular market conditions. The FSB also acknowledges that, after applying the proposed methodology, very few critical functions are likely to be identified. Insurance Europe concurs and would, therefore, question whether this is then the right approach to be taken in terms of the trade-off between regulatory burden and desired outcome.

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Answers to consultation questions

1. ***Are the definitions of "critical functions" and "critical shared services" appropriate for the insurance sector?***

The term "critical functions" is defined in the guidance using two elements: (1) critical functions are provided by an insurer to third parties not affiliated with the firm and (2) the sudden failure to provide that function would be likely to have a material impact on the financial system and the real economy, give rise to contagion, or undermine the general confidence of market participants.

The circumstances when sudden failure to provide a function may lead to a material impact on third parties are then set out as: (a) if no mechanism is in place to ensure the function's continuity and (b) the impact falls into one of the listed categories, such as: where the insurance coverage is vital for third parties to carry out economic activity or go about their daily lives; or policyholders are dependent on insurance payments being made to them; or where it may cause the insurer to dispose of large quantities of assets.

Given that this guidance relates to policy measures designed to address systemic risk, it is important that the focus of the assessment of critical functions is clearly based on their potential ability to materially affect the financial system and the real economy, as reflected in the FSB's definition of critical functions. Insurance Europe is concerned that, in discussing point (b) above, it is not sufficiently clear that these categories must be considered as part of the financial stability and real economy analysis, and may be read instead as inappropriately extending the potential scope of what may be a critical function beyond those activities that can be material to the financial system into areas covered by normal prudential regulation.

Insurance Europe, therefore, considers that the discussion of the categories should be amended to clarify that these must be read within the wider context of a likely material impact on the stability of the financial system and the real economy.

2. ***Should critical functions be identified based on whether the disruption of the activity would adversely impact the stability of the financial system or the functioning of the real economy, or both?***

Insurance Europe believes that there should be a much clearer distinction between measures addressing systemic risk and normal prudential regulation. These are in its view two separate work strands and crossing over between them would be wholly inappropriate. Critical functions should be identified exclusively according to their potential ability to materially affect the financial system and the real economy.

3. ***Is the methodology for identifying critical functions laid out in the paper appropriate for the insurance sector? If not, what aspects are missing or need to be changed?***

Insurance Europe regrets to see that the differences between the insurance and banking business models are still not fully taken into account in this proposal. This is an important concern which Insurance Europe has repeatedly raised in its past contributions. Even if in the new annex to the Key Attributes (dealing with the resolution of insurers) more recognition is given to this issue (a fact which Insurance Europe welcomes), it must highlight the following aspects in the present proposal where confusions are still being made:

- The focus on sudden failure and the sudden withdrawal of services is not appropriate. Insurance failure is different from the so-called "weekends of resolution" which occur in banking. In case of failure, an insurer would typically enter into run-off, so critical functions would not suddenly cease. Portfolio transfers are also generally not problematic.
- There is, in Insurance Europe's opinion, no evidence that the failure of a large insurer could have potential knock-on effects to other insurers, given that insurers are not interconnected as banks are.
- The FSB appears to continue to assume that primary insurers and reinsurers are highly interconnected and that they can consequently give rise to contagion upon failure. In reality, connections between

insurers and reinsurers are different in nature than those between banks. Specifically, the relationships are more between insurers and reinsurers, rather than between reinsurers themselves (i.e. the market has a hierarchical structure). This means that there is no network-like "interinsurance" market similar to the interbank market, in which reinsurers would play a prominent role. In addition, reinsurers don't concentrate a specific type of risk, like monoliners do. Therefore, the failure of a reinsurer would not spread to other primary insurers or indirectly to other reinsurers. Finally, only around 5% of global primary insurance premiums are ceded to reinsurers.

- Insurance Europe does not see how the failure of an insurance undertaking is supposed to cause funding or liquidity strains on borrowers. Regulatory requirements usually prohibit insurers to act as lenders (banks).

Given the very limited capacity for insurers to have functions which are critical, Insurance Europe believes that the identification process should not be overly time and resource consuming. For example, instead of applying the three-step identification process described in this guidance to every single insurance activity (including the traditional ones), a considerable number of activities can be excluded from the analysis right from the start (e.g. those which are highly substitutable or those in which an insurer has a very small market share). This would result in a more efficient and less burdensome process.

However, even with this simplified measure, it should be ensured that functions are only identified as critical where they have a real potential to severely affect financial stability and real economy. Otherwise, the identification process would be disproportionate and, in Insurance Europe's view, inappropriate.

4. Do the six broad categories of activities outlined below cover all relevant and potentially critical functions? What additional categories, if any, should be added?

All insurance is critical to those who buy it, as well as for the functioning of the economy. Insurance Europe doesn't see why regulators would attempt to decide which insurance lines are more critical than others.

Following the logic used in this document, to suggest that insurance can be critical for people to go about their daily lives, Insurance Europe notes that this same logic can apply (for example) to services provided by key players of other important industries such as energy/infrastructure, communication or transportation. In fact, their failure would have an even greater impact on people's lives than the potential withdrawal of their insurance policies.

Insurance Europe believes that the FSB has neither the mandate nor the resources to engage in such a granular analysis. The focus of this guidance should be strictly on those activities which could materially affect the financial system and the real economy.

8. Are there any other issues in relation to the identification of critical functions and critical shared services that it would be helpful for the FSB to clarify in further guidance?

The scope and purpose of the paper lacks clarity. The paper primarily focuses on the G-SIIs, yet the examples of critical functions are characteristics of traditional insurance and are likely to be more relevant at a domestic rather than global level.

Consequently, in Insurance Europe's view, the guidance drifts into dealing with domestic insurance markets, because it attempts to identify where a large market share in a product area may lead to significant negative externalities if the product is suddenly withdrawn. Insurance Europe would point out that this type of domestic competition analysis falls under the remit of competition authorities. The FSB should maintain its focus on risks to the global financial system.

Given that the list provided in the annex includes almost all insurance activities and products, Insurance Europe fears that the criticality assessment risks being disproportionate to the few critical functions that are expected to be identified as a result.

Insurance Europe understands that group supervisors (in the context of resolution planning) will be tasked with finding remedies after the identification of critical functions and shared services. A question left unanswered is how group supervisors will make public, for the benefit of prospective market entrants, where critical functions lie in a certain market.

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