

Insurance Europe response to the FSB consultation on effective resolution strategies for Global Systemically Important Insurers (G-SIIs)

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Key messages

- Insurance Europe acknowledges and welcomes the Financial Stability Board's (FSB) decision to limit the scope of the "critical functions" definition. However, the ultimate aim that the "critical functions" concept tries to achieve has still not been unambiguously defined. Therefore, Insurance Europe believes that a further clarification of this aspect is needed. There should also be recognition that designation of systemically important insurers and identification of critical functions are very different, and policymakers should not mix up these two approaches.
- Insurance Europe also welcomes the degree of flexibility introduced by the FSB to the approach to resolution strategies, including points of entry into resolution. This reflects the wide range of organisational structures in the insurance industry.
- Insurance Europe emphasises the importance of applying appropriate resolution tools and strategies, which are adapted to the reality that insurers' failures occur and can be managed over a long period of time.
- Insurance Europe welcomes the FSB's preference for portfolio transfers in the proposed guidance. Indeed, along with run-offs, portfolio transfers are sufficient to deal with the majority of insurance failures and these should therefore be the most preferred resolution tools.
- In the proposed guidance, it should be made clearer that a critical shared service supports a critical function. If the identification of critical functions triggers the imposition of additional requirements, these should provide sufficient benefit to justify the additional costs involved.
- The systemic risk potential of reinsurers is significantly limited by several factors: the total size of the reinsurance market is small compared to the size of the insurance market, there is no network-like inter-insurer market (so potential contagion channels are slow and tractable), there are low barriers to entry in the industry and know-how is highly transferrable (therefore, there is high substitutability). The last two considerations also apply to primary insurers.

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?

Insurance Europe agrees that identifying institution-specific objectives for resolution is a sensible approach, as long as these objectives are also made clear to the institutions.

2. Are the considerations for determining “points of entry into resolution” as discussed in Section I.1 appropriate and relevant for the insurance sector?

Insurance Europe believes that flexibility is important when determining points of entry into resolution. Insurance Europe also thinks it is necessary that resolution authorities have enough flexibility to also determine the most appropriate resolution strategy for the point of entry they choose (as opposed to being bound by the original strategy). The development of a preferred resolution strategy that best achieves the resolution objectives may depend on many factors, such as the existing structure and business model, the need for recapitalization, the necessity for preservation of diversification, or the degree of internal interconnectedness within the group.

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?

Insurance Europe agrees in general with the considerations laid out in these sections, but has a number of comments regarding several of the aspects discussed.

Section II.1 states that authorities may need to “require firms to make changes to legal and business structures to address such obstacles and improve their resolvability”. Insurance Europe would emphasise the importance of proportionality in the choice of resolution tools, given that insurers’ failures occur over a long period of time and that they can be managed without swift reorganisations. Such changes would also need to have due regard to the extent of any critical functions/services provided by the group and achieve a balance between ongoing operational efficiency versus the remote possibility of the need for the immediate (i.e. overnight) resolution of an insurer. Given the potentially high economic impact of reorganisation measures, it is important that they be imposed only in strict compliance with applicable legislation and that they respect of the principle of proportionality.

Section II.2 states that internal interconnectedness can lead to intra-group contagion. Insurance Europe believes that this risk should not be exaggerated, given that insurers manage liquidity in a different way than banks (i.e. funds backing liabilities towards policyholders remain within the entity which is liable).

Section III.1 places an emphasis on availability of life insurance cover on the same terms and pricing. This consideration would however not apply in cases when a life insurer’s failure occurs due to under-pricing.

Section III.1.b discusses substitutability and mentions that when property and casualty (P&C) insurance policies are “complex and unique”, authorities “may consider examining whether there are structural factors that led to a lack of substitutability which may need to be addressed by policy action in other domains (e.g. competition)”. Insurance Europe would emphasise that P&C insurance policies are substitutable, given that portfolio transfers are very common in insurance and that capital and expertise have in the past proven easy to

replace. Insurance Europe would also point out that the International Association of Insurance Superiors (IAIS) has recognised¹ that “a lack of substitutability does not appear to be an issue in the insurance industry”.

Section III.1.c gives two examples of how the failure of a reinsurer could give rise to contagion to the extent that it materially weakens other insurers or reinsurers. Insurance Europe would like to address both of these as follows:

- *The reinsurer defaults on monies owed under contracts of reinsurance.* Notwithstanding the very important role they play in supporting the activity of primary insurers by pooling tail risk globally, the interconnections between reinsurers and the rest of the financial system are unlikely to prove problematic from a systemic perspective. In fact, only around 5%² of global primary insurance premiums are ceded to reinsurers. This risk is partially passed on through insurance-linked securities to capital markets and other reinsurers. But total ILS issuance is equivalent to around 0.1% of global insurance premiums². Retrocession (which consists of reinsurers buying reinsurance) is considered the main channel of direct interaction between reinsurers. Retrocession is mainly used for peak risk exposures and amounts to 13% of global reinsurance premiums and a mere 0.6% of global insurance premiums. Risks are retroceded only once and this process rarely occurs between top reinsurers but more often involves second or third tier reinsurers. Consequently, there is no network-like inter-insurance market similar to the interbank market and the systemic risk potential is correspondingly much lower. It has been shown (in particular by the French regulator³) that even an extreme scenario in which all reinsurers in a market fail, would only adversely impact a small number of insurers, without leading to the materialisation of counterparty risk. As the IAIS noted in a 2011 study¹, “the (re)insurance sector has built in circuit breaks” and “connections between reinsurers are weak and most likely immaterial”.
- Primary insurers may fail because they can no longer share risks with reinsurers and that in some cases a highly specialised nature of the primary business will mean that very limited reinsurance alternatives are available. Know-how is highly substitutable in the industry, given the high fungibility of reinsurance experts. Individual failures will not lead to a shortage of reinsurance expertise, which will remain in the market giving continued reinsurance options for primary writers. At an industry wide level if major catastrophes lead to premium increases (a hard reinsurance market), the consequence will be that additional capital and reinsurance capacity will enter the market. This is possible because there are low barriers to entry into the reinsurance industry, as illustrated by the stable market share of the top 10 global reinsurers over the last decade (together, they represent around 40% of total ceded premiums). In addition, top reinsurers have very different shares of individual markets; this means that no reinsurer enjoys a dominant position at global level. Finally, if the reinsurance is provided to a primary business which is highly specialized, then it is also unlikely to be systemic and to satisfy the critical function criteria.

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?

Insurance Europe welcomes the fact that the FSB expresses a preference for portfolio transfers in the proposed guidance. Indeed, along with run-offs, portfolio transfers are sufficient to deal with the large majority of insurance failures. Therefore these should be the most preferred tools and authorities should clearly explain when using more intrusive tools why run-off or portfolio transfers are not sufficient to meet the objectives of resolution. Insurance Europe would also like to re-emphasise that, since failures take longer in insurance, rapid intervention will not prove a good reason for choice of resolution tools, especially because fire-sales of assets or the crystallisation of their value could result in unnecessary value destruction.

¹ IAIS (2011)- “[Insurance and Financial Stability](#)”

² SwissRe, MunichRe Economic Research

³ Frey, Tavoraro, Viol (2013) – « [Analyse du risque de contrepartie de la réassurance pour les assureurs français](#) », Autorité de Contrôle Prudentiel – Débats économiques et financiers, 4/2013

Insurance Europe continues to view stay and suspension powers favourably, precisely because they preserve value and can very often prevent the need to use more drastic measures within the resolution toolkit. In addition, this tool has proven its effectiveness in previous insurer failures. Insurance Europe would add that stay and suspension powers could not only be applicable to cashing out annuities, but also to switching accounts or to service or infrastructure contracts.

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?

Insurance Europe believes that the FSB guidance as proposed is flexible enough to take account of the different types of business undertaken by global systemically important insurer (G-SIIs). It is important that the final guidance does not prescribe the requirements that must be met, so as to preserve this flexibility.

Section III.1.d addresses financial market activities and investment products. Insurance Europe notes that an insurance resolution regime should not be designed around the unlikely occurrence of a “fire sale”. Fire sales are uncommon in insurance because of the lack of maturity transformation and the fact that insurers strive to match the duration of their assets and liabilities. Moreover, the additional benefits frequently offered by insurance products such as health cover/life insurance or guarantees, act as a disincentive for policyholders to surrender. Therefore, Insurance Europe welcomes the recognition that resolution authorities may need to take action to avoid “fire-sales”, as caution must be exercised when imposing requirements based on a minority of cases.

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?

Insurance Europe welcomes the improvements made to the approach to identifying critical functions after last year’s consultation. Particularly positive is the revised definition of critical functions as those and only those that would be likely to have a material impact on the financial system and the real economy if they failed. Insurance Europe fully agrees that functions which do not have a significant impact on economic and financial stability, or that can be easily substituted, should not be considered critical.

Insurance Europe approves of the reference to a firm-specific analysis, taking into account the fact that critical functions vary by firm and jurisdiction.

Insurance Europe would re-emphasise that because insurers’ failure is managed over a long time period, it follows that critical functions are not suddenly withdrawn on resolution. Therefore, any regulatory response should be proportionate so as not to lower incentives for insurance provisions or raise costs for policyholders. In addition, it should be transparent to the firm if they have been identified as having a critical function and a consistent approach is needed at global level to identify critical functions and critical shared services.

Insurance Europe notes that the designation of systemically important insurers and the identification of critical functions are fundamentally different processes with different objectives. The FSB guidance however remains insufficiently clear in that regard. Further explanation is needed on the objective of the “critical functions” concept (prevention of systemic risk vs. policyholder/taxpayer protection) and the ultimate outcome it tries to achieve (orderly run-off vs. forced recovery, i.e. maintenance of the ability to write new business). A clarification would help all relevant stakeholders, policymakers, resolution authorities and the industry, delineate these two processes at all times.

Section III.2.c introduces a new approach which would require regulators to specify through an objective what functions are intended to be continued. Insurance Europe agrees with this approach and also believes that it

should be recognised that resolution planning will differ according to the objective selected. Regarding continuity of cover, there is a distinction to be made on life policies. If the objective is the continuity of existing cover, then policies can be run-off or transferred to a different insurer; but if the resolution objective is to continue to write new business, it is hard to envisage where a different insurer would not be able to meet policyholder needs. It may be that the new cover is not the same price or format. However, the aim should not be replicating legacy products, but rather ensuring that substitute cover at a reasonable price is available.

Section III.3 discusses critical shared services. Because the list of such services provided is very extensive, Insurance Europe believes that it should be made clearer that a critical shared service supports a critical function. In addition, any requirements regarding the treatment of critical shared functions should take into account that (re)insurance resolution tools such as run-off will be implemented over a period of time. Such requirements must also be based on a sound legal basis. Policy choices made under prudential regulation should be respected and it should be understood that no framework can completely eliminate the risk of failure at an acceptable cost to policyholders.

Insurance Europe agrees with the aim of ensuring continuity of shared services in resolution, and welcomes the acknowledgement that this can be achieved in more ways than those exemplified in the guidance. In Insurance Europe's view, further clarification may be needed regarding the following aspects:

- The language in Box 3, given that the introductory line indicates that these are arrangements which "could" be followed, however in subsequent points it is suggested that these are arrangements which "should" be followed. Insurance Europe believes that it should be recognised that other considerations may be more appropriate given the circumstances of the insurer and that therefore the language used here should be less prescriptive.
- Insurance Europe agrees that clearly documented contractual arrangements and service level agreements should be in place for the provision of intra-group and third party critical shared services. Good practice in terms of service agreements should be universal and not a requirement linked only to systemic institutions.
- In relation to financial resources, it is important to recognise that insurers already have provision for expenses in the calculation of their liabilities and it will be for the administrator to decide immediate funding priorities, e.g. ensuring that a third party can be paid. Insurance Europe are not aware of examples when insurance administrators failed to pay external suppliers.
- Finally, Insurance Europe is concerned that the suggestion to potentially separate reporting lines for functions such as HR and IT (under "Governance") could be costly and time-consuming.

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?

Section IV.1 discusses resolution plans. Insurance Europe believes that the operational resolution plans need to be tailored to the circumstances of the (re)insurer and transparent to firms. The plans should also be flexible, allowing authorities to take into account the circumstances of resolution. Insurance resolution does not have the same urgency as bank resolution, and tools such as portfolio transfer and run-off facilitate this longer term process. Authorities should therefore be in a position to adapt their approach and plans as the situation evolves.

Section IV.3 refers to resolution triggers. Insurance Europe agrees that resolution triggers should not be fully defined, so as to leave the regulator sufficient flexibility to take appropriate action. Indeed, an assessment of when an insurer's liabilities exceeds its assets requires significant judgment on the part of the resolution authority (as asset values fluctuate and so too do liabilities, which are merely best estimates of expected claims/maturities rather than certain amounts). Pre-agreed resolution triggers should be fully transparent to insurance companies.

Section IV.4 refers to cooperation agreements (COAGs). Insurance Europe agrees in principle with the concept, as effective cooperation between authorities will lead to more integrated and coordinated supervision of



(re)insurance groups. Aspects of cross-border cooperation are described in the “FSB Guidance on Cooperation and Information Sharing with Host Authorities of Jurisdictions where a G-SIFI has a Systemic Presence that are Not Represented on its CMG” released on November 3, 2015. However, it is understood that any cross-border cooperation must be developed in accordance with the rule of law. Given that cooperation will not be a legal requirement, more information should be provided on how this will be achieved from a practical perspective and on whether further actions should be put in place to support this (e.g. revisiting the IAIS ComFrame ICPs on supervisory cooperation).

Section IV.5 discusses information systems and data requirements. Given the complexity of fully identifying who will be eligible for compensation under policyholder protection schemes in advance (eligibility is established at the point of resolution), Insurance Europe believes that efforts should be focussed on facilitating the process that would enable the identification of eligible policyholders in resolution.

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?

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers generate premium income of almost €1 170bn, employ over one million people and invest nearly €9 900bn in the economy.