

PCI Comments

FSB Request for Comment

Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services

December 15, 2014

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to offer comments on the Financial Stability Board's (FSB) proposed guidance document on identifying critical functions and critical shared services with respect to systemically important insurers. PCI is a U.S.-based trade association composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than \$210 billion in annual premium, 39 percent of the property casualty insurance in the U.S. PCI members write insurance and reinsurance throughout the world. Among our members are companies designated as systemically important and globally systemically important as well some that potentially would be subject to enhanced supervision as internationally active insurance groups.

Scope. PCI's primary concern relates to the scope of the Guidance. Although the title of the Guidance explicitly refers to "Systemically Important Insurers," the description of the Guidance's scope indicates that it applies to "insurance or reinsurance companies, groups, and conglomerates that could be systemically significant *or critical if they fail*" (emphasis added). As PCI noted in our October 15, 2013 comments on Key Attributes of Insurance Resolution Regimes, the term "critical if they fail" appears to apply to insurers that have not been designated as systemically important either by the FSB or by the insurer's home regulator. We are greatly disappointed that the final Key Attributes document continues to apply to insurers that could be "critical if they fail" and are equally disappointed that the term continues to appear in the Guidance.

A working group of the National Association of Insurance Commissioners (NAIC) recently considered and sought public comment on the question of whether non-systemically important insurers should be required to develop resolution plans. The public response was overwhelmingly against such a requirement and the NAIC decided not to pursue the matter further at this time. While we understand the FSB's mission to be to address systemic risk posed by global financial firms, we do not understand the FSB's mission to be to seek to exert regulatory authority over insurers that have not been designated as systemically important. By seeking to apply these documents to companies that "could be systemically important" (but have not been so designated) or to companies that could be "critical if they fail," the FSB casts an inappropriately wide net, which creates a specter of unwarranted incursions into the regulatory authority of domiciliary regulators over non-systemically important insurers. The FSB has offered no explanation or rationale as to why it should be involved in resolution issues relating to non-systemically important insurers. We strongly urge the FSB to limit expressly the application of any guidance or other documents relating to the regulation of insurance to companies that have been designated as systemically important.

Critical Functions. The Guidance lists an exceedingly broad variety of property casualty insurance products and activities that could be "critical" for various reasons. Although the Guidance does not

expressly state that these critical functions pose systemic risk, it defines “critical functions” as those for which “failure would lead to the disruption of services that are vital for financial stability and the real economy due to the insurer’s size or market share, external and internal interconnectedness, complexity or cross-border activities.” This definition bears stark similarities to the type of factors U.S. and global regulators, including the FSB, look for in determining systemic risk. For this reason, PCI is extremely concerned that the identification of “critical functions” in the manner proposed, coupled with the over-broad scope of the Guidance (which threatens to take in non-systemically important institutions), could result in a massive over-reach in which global regulators effectively impose systemic risk-like regulation on companies that are not systemically important.

PCI’s concerns are compounded by the discussion of how and why certain functions are identified as critical and, in particular, the illustrative listing in the Annex of various products and activities that could be critical. These include the underwriting of a number of products (*e.g.*, directors and officers liability insurance, product liability insurance, workers compensation insurance, motor car liability insurance, travel insurance, building, flood or earthquake risks, etc.). The failure of a very large firm providing these products might well cause temporary disruption in the market served, but PCI knows of no firms providing such products for which failure would be likely to pose systemic risk to the national or global economy. It is therefore unclear why these products should be designated as even potentially “critical” given the strong connection between criticality and systemic importance that the Guidance implies.

The FSB’s own methodology for identifying G-SIIs states that there is no evidence that traditional insurance either generates or amplifies systemic risk and says that “the potential for systemic importance is only considered to arise in any non-traditional or non-insurance activities.” It is therefore unclear why products that the FSB has not identified as posing systemic risk should now be considered “critical” and thus a potential threat to “financial stability and the real economy” in the context of the Guidance.

To its credit, the Guidance does include various helpful references that militate against finding many of the products listed in the Annex as critical, including a discussion of the need for substitutability analysis. Indeed, the Guidance states that very few critical functions are likely to be identified. However, the listing of many functions as potentially critical when they would be most unlikely to pose systemic risk will almost uncertainly lead to confusion over exactly how the FSB views criticality. The consequences of a product or activity being labeled as “critical” are not clear beyond a requirement that they be addressed in a resolution or recovery plan. Again, this confusion could be significantly ameliorated if references to “critical if they fail” were removed, the Guidance were explicitly made applicable only to companies designated as G-SIIs, and the Guidance avoided references to products and activities as “critical” that are unlikely ever to pose systemic risk.

Finally, while PCI appreciates the Guidance’s emphasis on the importance of policyholder protection schemes, we disagree with the Guidance’s contention that “payments supported by unfunded policyholder protection schemes may be more likely to spread industry contagion . . .” As the FSB is aware, the U.S. state-based regulatory system includes a post-funded guaranty fund system that has worked extremely well to protect policyholders. At no time has the failure of any U.S. insurer engaging only in traditional insurance activities posed systemic risk and it follows that the post-funded nature of the U.S. guaranty fund system also poses no systemic risk. The Guidance makes particular reference to workers compensation insurance and the need for guaranty funds to generate liquidity quickly in the short term to respond to claims on behalf of an insolvent insurer. In fact, the most significant liabilities faced by workers compensation insurers are generally those paid out over a long period of time to fund

long-term medical needs of claimants. As a result, the concern the FSB suggests has not arisen in the U.S. to date. PCI is not aware of any shortcomings in the state guaranty fund system that have limited its ability to respond to workers compensation claims and certainly none that posed systemic risk.

PCI urges that the Guidance be amended to eliminate the concerns we have noted. We would be pleased to respond to questions or to offer any other assistance as may be helpful to the FSB.