Swiss Re Response to 3 Nov 2015 FSB Consultation "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers"

Introduction

Swiss Re is pleased to submit a response to the FSB's Consultative Document (CD) on "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers". This response expands upon our response in 2014 to the FSB consultation on the identification of critical functions in insurance. We appreciate that many of our comments have so far been considered and adopted by the FSB. For this consultation, we seek to provide further constructive responses in areas where we believe the document can be further improved. Our answers to the consultation questions include both general commentary and specific responses.

We recognize that the CD provides a degree of flexibility regarding the identification of points of entry into resolution. We greatly appreciate this, given that insurers operate with a range of business models for which different resolution strategies are most appropriate. As a result, we believe such flexibility is essential.

For reinsurers, we believe that it is imperative that the resolution strategy avoids unnecessary destruction of the value provided by exploiting diversification. Ensuring international contract certainty is the means that best maintains the value that reinsurance realises by providing global and national economies with the benefits of international diversification. The resolution strategy should also recognize the fact that re/insurers have longer-term liability durations than other types of financial institutions – as a result, some aspects of resolution that have been realized for banks, such as overnight capital provisions and a-priori restructuring are unnecessary and, due to the associated costs, counterproductive for re/insurers.

We appreciate that the FSB has provided a refined definition of critical functions to better account for the specificities of the insurance business model. It is our understanding that the CD reflects a general agreement of the FSB with our belief that insurers and reinsurers do not carry out critical functions.

Swiss Re appreciates the constructive collaboration with the FSB – as well as the IAIS and other stakeholders – and remains committed to supporting its effort in developing an effective and reliable worldwide resolution framework. It is our firm conviction that this can only be achieved if resolution strategies adequately reflect the business model of insurance and reinsurance.

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?

- We are very supportive of institution-specific approaches, in particular the acknowledgment that the development of a preferred resolution strategy depends on the business model of the firm.
- The determination of the appropriate resolution strategy should be carried out by the Group-Wide Supervisor and Crisis Management Group. No further guidance is necessary.

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

- We welcome the FSB's approach for determining "points of entry" into resolution, in particular the recognition that a range of point-of-entry approaches should be considered.
- We welcome that specific terminology for the insurance business was chosen to mark the specificities of the insurance sector.

- For reinsurers, we believe that it is imperative that the resolution strategy avoids unnecessary destruction of diversification. Ensuring international contract certainty through resolution is the means that best maintains the value that reinsurance realises by providing global and national economies with the benefits of international diversification.

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?

- We fully appreciate and largely agree with the considerations in Section II and the underlying analysis in Section III. We especially appreciate that traditional run-off and portfolio transfers are recognized as effective resolution tools.
- We would strongly encourage the FSB to explicitly mention in Section III.1.c that resolution strategies for reinsurers should consider how to avoid unnecessary destruction of diversification benefits.
- A priori restructuring of existing legal and business structures, as proposed by the CD, would have likely lead to negative consequences for policyholders, as increased costs associated with the restructuring of efficient and effective business structures would be borne on them. Rather than focus on a priori measures, Group-wide Supervisors and Crisis Management Groups should make use of the range of resolution strategies available to them to determine the one that is most appropriate given the existing business and operating model of the firm. We are convinced that this approach is highly preferable from a cost-benefit perspective.
- In general, we would urge the FSB to keep in mind that the timeframe for resolution of insurers is considerably longer than for banks, due to insurers' significantly longer liability durations. A relevant timeframe for a typical insurer would be years rather than days. This should be explicitly taken into account by authorities when choosing a resolution strategy. In light of this, a-priori measures, such as restructuring or TLAC (see also response to Question 4) are unnecessary and even counterproductive.
- With regards to *Section III.6: Nature and location of loss absorbing capacity in resolution* – we are concerned about the use of the term "loss absorbing capacity", since this is closely associated with a concept of Total Loss Absorbing Capacity (TLAC) which is not applicable for insurers and reinsurers. In modern risk based solvency regimes expected losses and capital costs to cover unexpected losses during the whole run-off of in-force liabilities are covered by technical provisions, irrespective of whether the source of the loss is a systemic activity or not. Finally, no additional capital is needed to ensure the substitutability of (re)insurance covers (not yet written business). We would advocate that this section make reference to "capital resources", so that the question of TLAC in insurance can be addressed separately in due course, see also our answer to Question 4
- Section III.1.c states "The resolution strategy for a reinsurer will need to address how to mitigate the risk that the failure of a reinsurer would give rise to contagion to the extent that it materially weakens other insurers or reinsurers. This might be the case, for example, if the reinsurer defaults on monies owed under contracts of reinsurance or if the business model of the primary insurer fails because it is unable to continue sharing risks. In some cases, the highly specialised nature of the primary business means that very limited reinsurance alternatives are available."
    - ⇨ Swiss Re strongly supports explicitly encouraging reinsurers and their supervisors to address these concerns e.g. with empirical data, including scenario analysis etc.
    - ⇨ Further, we disagree with the statement that "in some cases, the highly specialised nature of the primary business means that very limited reinsurance alternatives are available." Even in the event of the failure of a reinsurer operating in highly specialized business lines, experience shows that 1) expertise is highly transferable and 2) appropriate capacity is generated with ease for reinsurers in distress, even before entering into resolution, e.g. Converium.

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?

- We propose that the term "bail-in" should be used only in the context of a restructuring that includes policyholder liabilities. The term "loss absorbing capacity" should be avoided. While LAC or TLAC might be useful for banks – especially as it provides additional capital swiftly, i.e. overnight, this aspect is not relevant in insurance. As we mention in our response to Question 3, we would urge the FSB to keep in mind that the timeframe for resolution of insurers is considerably longer than for banks, due to insurers' significantly longer liability durations. Moreover and most importantly, there are several well-established mechanisms to cover losses in insurance: technical provisions for the expected losses and a comprehensive capital requirement for stress situations. In addition, capital costs to cover unexpected losses during the whole run-off of in-force liabilities are covered by technical provisions, irrespective of whether the source of the loss is a systemic activity or not. Finally, no additional capital is needed to ensure the substitutability of (re)insurance covers (not yet written business). For insurers that are deemed systemically important there is even a specific higher loss absorption (HLA) on top of that. Another additional layer and associated costs for bail-in-able debt is unnecessary and counterproductive.

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?

- Yes, we believe the framework is indeed appropriately flexible and appreciate that the FSB has considered the industry input.

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?

- We agree strongly with the proposed approach. We welcome that our comment was carefully considered that the sudden failure to provide that function would be likely to have a material impact on the financial system **and** the real economy. We continue to believe that insurance and reinsurance do not carry out critical functions. In relation to critical functions, substitutability should be on the basis of a 'reasonable' rather than 'minimum' amount of time. This is reflective of the fact that the timeframe for resolution of insurers is considerably longer than for banks, due to insurers' significantly longer liability durations.
- We support that proposed approach for identification of critical shared services unambiguously links critical shared services with the concept of critical functions. We believe that critical shared services should be identified as such only if they are necessary to ensure the provision of a critical function.

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?

- We agree with the principle of COAGs in Section IV.4. Mechanisms should be in place to ensure that cross-border cooperation agreements are enforced.

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?

- Relating to our response to Question 7 above, the FSB should consider releasing a version of the recent November 3rd publication "Principles for Cross-Border Effectiveness of Resolution Actions" with a focus on insurers and reinsurers.