Munich RE

We would like to thank the FSB for inviting comments on the Consultative Document "Effective Resolution of Systemically Important Financial Institutions (the "Consultative Document"), issued on 19 July 2011.

The Consultative Document deals with proposed policy measures and notes for discussion for systemically important financial institutions (SIFIs).

This process was prompted by the recent financial and economic crisis, which was principally triggered by banks. It can therefore be assumed that some banks will be classified as systemically relevant (G-SIBs) and will be subject to additional supervisory regulations.

(Re)insurers did not trigger or noticeably contribute to or amplify the financial crisis. On the contrary, (re)insurers acted as stabilisers during the financial crisis. Consequently, we believe that insurers will not be classified as G-SIFIs and that the regulations proposed in the Consultative Document will not apply to insurers. This is especially true of the proposed regulations pertaining to recovery and resolution plans.

As a lender of capital to banks, the insurance industry would be affected by the measures proposed and discussed under the Consultative Document.

Questions for public consultation

Effective resolution regimes

1 Comment is invited on whether **Annex 1: Key Attributes of Effective Resolution Regimes** appropriately covers the attributes that all jurisdictions' resolution regimes and the tools available under those regimes should have.

2 Is the overarching framework provided by **Annex 1: Key Attributes of Effective Resolution Regimes** specific enough, yet flexible enough to cover the differing circumstances of different types of jurisdictions and financial institutions?

The objectives of authorities involved in a resolution case should be aligned to protect depositors, policyholders and other customers and treat them equally irrespective of the country of residence. Depositors, policyholders and other customers should be treated in a similar way, irrespective of the contractual partner, be it the parent company, a subsidiary or a branch.

It could well make sense to appoint the supervisory authority or the licensing authority as the "leading" resolution authority rather than having a third party with limited understanding of the business and the group in question.

It would also be helpful if the resolution authority would be able to enter into MMoUs with other supervisory authorities and into mutual recognition agreements about prudential supervision. Both, MMoUs and mutual recognition agreements could include rules on recovery and resolution scenarios.

Coordination of action between supervisors in a stress scenario is of key importance. Unilateral actions from local authorities, for example a freezing of assets in a foreign subsidiary should be avoided.

Recovery and resolution planning is difficult to comment on in detail, as such plans in the form proposed do not exist at this time. In accordance with current applicable law, a recovery plan has to be set up if the target capital has not been achieved and the supervisory authority prescribes such a measure.

The measures proposed in the Consultative Paper go far beyond this current system. A particular problem appears to be the call for ex ante plans. For example, possible specific resolution or recovery options under stressed conditions generally depend on the type of stress. There is a myriad of possible causes for stressed conditions, and practical and adequate responses to each of such situations differ. We therefore believe that comprehensive ex ante plans effectively cannot exist.

We do believe that there should be a process in place that would identify a firm in difficulties and in time and that would trigger certain action – for instance, a breach of a certain capital threshold as foreseen in current prudential regulation.

Bail-in powers

The increasing discussion on creditor participation such as loss-bearing bonds suggests that the existing risk management framework and risk assumptions for banks as well as capital and liquidity requirements for banks are currently inadequate or insufficient.

The proposed bail-in mechanisms should in the first instance focus on equity and other instruments of ownership. The rights of equity capital financiers should be reduced to the extent possible before even a marginal impairment is made on the rights of lenders.

Insurers and other professional investors usually manage their investments with a long-term motivation and not speculatively. Future investments in asset classes that are subject to bail-in mechanisms will be influenced by a number of considerations, for example:

- The proposed measures will inevitably result in higher spreads and thus make hybrid capital arrangements generally less attractive.
- It is likely that investments subject to statutory bail-in mechanisms will also require higher risk capital since the probability of a (partial) default increases.
- And thirdly, bail-in mechanisms create additional uncertainty for insurers as it is not clear if and to what extent investments subject to a statutory bail-in can be qualified as assets covering technical provision (“coverage assets” or “admitted assets”) according to insurance regulation.

In order to provide for an attractive environment for potential investors in contingent convertible bonds, proposed measures should at least be implemented in a transparent way without having retroactive effects. From an investor's point of view, transparency can be achieved through objective and quantitatively verifiable criteria with respect to the conditions for bail-in mechanisms.

To prevent regulatory arbitrage and ensure a level playing field, the relevant decisions in a restructuring process should be coordinated in an orderly manner. It is difficult to predict whether this can be better achieved within a college of supervisors, including a leading group supervisor, or through a single authority. From an unbiased perspective, a decision by a single authority with far-reaching powers that would bind as many authorities and market participants as possible seems to be preferable.

We take note that the proposed statutory bail-in powers would not prevent firms from issuing instruments that write down or convert contractually. From a purely investors' point of view, it could have been argued that the focus should have been placed exclusively on contractual but standardised solutions as this would put investors and issuer in a position to structure the parameters in advance and in an acceptable way pursuant to some minimum regulatory requirements.

3 Are the elements identified in **Annex 2: Bail-in within Resolution: Elements for inclusion in the Key Attributes** sufficiently specific to ensure that a bail-in regime is comprehensive, transparent and effective, while sufficiently general to be adaptable to the specific needs and legal frameworks of different jurisdictions?

In general, we consider the identified elements to be sufficiently specific. It would be helpful if triggers (Section 4, Annex 2) are transparent and clearly specified.

Harmonisation with existing legal frameworks and other legislative proposals is necessary.

4 Is *it desirable that the scope of liabilities covered by statutory bail-in powers is as broad as possible, and that this scope is by and large similarly defined across countries?*

If statutory bail-in powers are introduced, the hierarchy of the capital structure should be respected (see p. 38). All creditors in a specific asset class should be treated equally. A similar definition across countries is desirable. A level playing field is important. Regulatory discretion should be limited to the extent possible in order to provide for a uniform application.

Please refer also to question 6 for exclusions.

5 *What classes of debt or liabilities should be within the scope of statutory bail-in powers?*

If statutory bail-in powers are introduced, senior unsecured and subordinated bonds should be covered; but a grandfathering for securities that were issued prior to the date that this legislation becomes effective would be preferable.

6 *What classes of debt or liabilities should be outside the scope of statutory bail-in powers?*

Covered bonds, liabilities to retail clients, cash in general, derivatives, structured finance.

7 *Will it be necessary that authorities monitor whether firms' balance sheets contain at all times a sufficient amount of liabilities covered by bail-in powers and that, if that is not the case, they consider requiring a minimum level of bail-in debt?*

If so, how should the minimum amount be calibrated and what form should such a requirement take, e.g.:

a. *a certain percentage of risk-weighted assets in bail-inable liabilities, +*

   or

b. *a limit on the degree of asset encumbrance (e.g., through use as collateral)?*

Usually, if authorities find that a group's risk profile is not commensurate with its capital, authorities should in the first instance require additional own capital. Liabilities subject to bail-in mechanisms are supposed to serve as an additional buffer in a real crisis situation and should be limited to a certain extent. Again, before a crisis, banks should be required to either assume more capital or de-risk when the authorities believe that the business is undercapitalised. In our view, total liabilities subject to bail-in mechanisms should not exceed a certain limit of a bank's own capital, e.g. 5%.

If there is to be a minimum amount of liabilities subject to a bail-in, such minimum should be a percentage of risk-weighted assets in bail-inable liabilities.

8 *What consequences for banks' funding and credit supply to the economy would you expect from the introduction of any such required minimum amount of bail-inable liabilities?*

A minimum amount of bail-inable liabilities will result in higher funding costs. From an economic perspective, the impact on the credit supply is rather limited if measurable at all.

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