CEA
Insurers of Europe

Position Paper

CEA response to the FSB consultation on Effective Resolution of SIFIs

CEA reference:	IAR-11-210	Date:	31 August 2011
Referring to:			
Related CEA documents:			
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Pages:	3		

Introduction and scope of the consultation

The CEA (European Insurance and Reinsurance Federation) welcomes the opportunity to comment on the FSB initiative which aims to develop an international framework to facilitate the orderly resolution of institutions deemed 'too big to fail'. As a preliminary remark, the CEA would like to underline that the scope of application of these policy recommendations should clearly distinguish between different sectors of the financial industry, and in particular between the banking and insurance sectors.

The CEA agrees that "not all resolution powers set out in the Key Attributes are suitable for all sectors and all circumstances" as said in Annex One, but is concerned that the rest of the paper has a less clear scope. The framework and tools set out for effective resolution of financial groups should properly account for the differences between banking and insurance business models.

Taking this into account, the CEA would like the FSB to clarify that its recommendations have been developed for the banking sector and should apply to this sector only.

The following general concerns should be noted:

- Any potential FSB resolution framework for the insurance sector should take into account the work underway at the IAIS and the discussions on the methodology to identify insurance undertakings as systemically relevant. In general, it is key that the timelines for the identification and the introduction of possible measures on G-SIFIs in insurance are de-linked from the FSB work regarding the banking system;
- The exchange of confidential information between a wide range of authorities as mentioned in the consultation is an area that raises strong concerns for the CEA and, as a strong pre-requisite, should rely on confidentiality agreements.

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Need to reflect the specificities of the insurance business model

The CEA calls on the FSB to reflect the specificities of each sector in its policy recommendations. Particularly, no insurer has caused "systemic disruption" in a wind-up scenario[1], and we share the view of the IAIS[2] that there is little evidence of regulated insurance companies having either generated or amplified systemic risk within the financial system itself or in the real economy.

Partly, this is due to the specificities of insurers' business model, which is very different to that of banking when it comes to both resolvability and potential systemic impact. Concretely, since insurers match expected future claims by policyholders with sufficient assets and since most assets are long term funded, an orderly wind-up is much easier than short-term fire sales caused by liquidity shortages. Besides, these liabilities present long-maturities that can only be seized by policy-holders under certain conditions.

The liquidity risk in the insurance sector is low as any impact only occurs over time and inter-company funding in insurance is rare and not part of the core business model.

In a wind-up process, insurers' assets do not need to be liquidated immediately, but rather only when claims need to be paid. As this process may take years, regulators have the time to intervene and reduce potential losses. The longer incubation time in the insurance sector allows the supervisory ladder of intervention to function effectively.

Insurers as institutional investors

In the consultation document, the FSB seeks views on the opportunity to include bail-in aspects in its proposed resolution approach. Taking into account the role of the insurance sector investors, the CEA wishes to highlight that from an investor's perspective, bail-in debt instruments raise a number of important questions which can limit their attractiveness.

The main concerns are on the uncertainty which can result from a statutory conversion, and on the risk pricing of these instruments as a consequence. The CEA considers that creditors' participations should only be considered on a contractual basis with no retroactive effects and only after reasonable measures to allocate additional equity or to de-risk the operations of the institution are exhausted or failed. However, in the event statutory bail-in is pursued by regulators, it must be clearly defined and applied only at the point of non-viability, in order to provide certainty for the markets and to preserve the creditor hierarchy.

In addition, the CEA would like to see further clarity in the scope of compensating mechanisms in case of haircuts or write-downs that turn out to be greater than needed. We believe in any event that appropriate compensation in these cases should be effectively guaranteed.

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[1] The insurance sector was on the periphery of this crisis. It should be noted that the crisis of AIG was raised by the Financial Products Division which was a non-insurance entity outside the scope of insurance regulation. The AIG insurance business units remained viable.

[2] IAIS position statement on key financial stability issues, 4 June 2010

Need to take into account EU insurance legislation

We understand that the FSB's intention is to expand its framework on resolution to the insurance sector at a later stage, as mentioned in the consultation paper. In this regard, the CEA urges the FSB to take into account the existing and proposed EU regulation which addresses some of the issues of the consultation.

Concretely, the Solvency II Directive already ensures group supervision and supervisory coordination through the "college of supervisors" a permanent structure for cooperation and coordination among the supervisory authorities of the Member States concerned. In this framework, credit institutions, investment firms and financial institutions are incorporated in the group solvency calculations.

The Solvency II holistic and economic risk-based prudential regulatory framework sets two levels of capital requirements and gives management and supervisors the time to apply a progressive set of corrective measures. On top of the technical provisions, which generally cover policyholder claims, there is a minimum capital requirement (MCR) and a solvency capital requirement (SCR).

The Solvency II directive also addresses the need for a recovery plan. In particular, a breach of the Solvency Capital Requirement (SCR) would require the insurer concerned to submit a realistic recovery plan for approval by the supervisory authority. This way, the Solvency II regulatory framework proposes a tailored recovery plan with clear triggers, which would be more suitable taking into account the slow deterioration process of an insurer's financial position, and would make unnecessary the existence of an ongoing recovery plan. The CEA would also like to note that the current consultation does not propose a clear and consistent trigger for the entry into early intervention or resolution.

Finally, the CEA would like the FSB to note that the Solvency II framework sets up a clear distinction between home and host country responsibilities, while the current FSB consultation paper proposes that the resolution authorities will have power over foreign branches. This may create confusion and does not fit in the EU current legislation.

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The CEA would like to thank the FSB for the possibility given to engage in the debate by participating in the consultation and for considering the views of European insurers. In view of the importance of international consistency in any approach the CEA stands ready and willing to contribute further to the debate.