

FSB Consultation on the implementation of the Key Attributes to the Resolution of Insurers

Allianz Reply

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Allianz SE appreciates the opportunity given by the FSB to respond to its consultation on the implementation of the Key Attributes of Effective Resolution Regimes to the Resolution of Insurers (the “**Insurance Key Attributes**”). Together with Axa, Aviva, Generali and Prudential it has contributed to the replies of the Geneva Association, Insurance Europe, the IIF and the German Insurance Association which we support and to which reference is hereby made. In addition Allianz would like to make the following observations:

I General Comments

1. Like any regulation also systemic risk regulation must be subject to democratic accountability: AZ understands the need to address truly global issues on a global basis. However, we are concerned that in the context of systemic risk regulation sometimes the expectation appears to be that new regulation will be implemented first by the targeted companies with national legislation to follow implementing only what has already been agreed upon on global level. Care should be taken to ensure democratic accountability during the process also to ensure its general acceptance.
2. Any systemic risk related standards setting should be transparent (i.e. providing for broad stakeholder consultation) and comply with the rule of law, i.e. it should, in particular, be possible to challenge regulation in court and the regulation needs to be proportionate to the likelihood of the realization of the risk it is meant to mitigate, properly (i) taking into account the characteristics of the insurance business model and (ii) existing prudential regimes (such as Solveny II).
3. No new regulation, at least no legislation of the expected severity and with the potential of **distorting the level playing field with competitors**, should be introduced without any prior assessment whether or not already existing measures are sufficient and without a field testing focusing on the potential effects for the targeted companies, its clients and the respective market.
4. In determining the **objectives of the Insurance Key Attributes** the FSB should bear in mind **its global mandate**, i.e. the mitigation of systemic risks posed to the global financial system. In addressing policyholder protection the Insurance Key Attributes seem to focus on issues which, lacking global impact, belong in the realm of local regulators.
5. Measures concerning the restructuring of liabilities are likely to encroach on ownership rights and must comply with the principle of proportionality generally recognized in all legal systems based on the rule of law. Regarding the identification of the relevant resolution authority this means that a clear distinction needs to be drawn between additional powers to be granted to the insurance regulator acting as administrative insurance supervisory body on the one hand and additional instruments that are made available in connection with an insolvency procedure under the control of an insolvency court.

II Issues highlighted by the Consultation

22. Are the general resolution powers specified in KA 3.2, as elaborated in this draft guidance, together with the insurance-specific powers of portfolio transfer and run-off, as specified in KA 3.7, sufficient for the effective resolution of all insurers that might be systemically important or critical in failure, irrespective of size and the kind of insurance activities (traditional and 'non-traditional, non-insurance' (NTNI)) that they carry out? What additional powers (if any) might be required?

The Insurance Key Attributes seem to strive to list all measures one could theoretically think of in a resolution scenario. However, the objective should not be to come up with the most comprehensive list of resolution measures but adequate and proportionate tools for addressing systemic activities. The introduction of new terms like "critical in failure", "vital economic functions", "essential and systemically important functions" and "critical types of insurance policies" shifts away the focus from dealing with systemic risk (defined by the FSB as the risk of a disruption to the flow of financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy) to assessing the general viability and maintenance of insurers in recovery or resolution scenarios. The latter is a much broader concept which might be difficult to reconcile with the mandate of an international body like the FSB specifically entrusted with focussing on risks to the global financial system.

23. Should the draft guidance distinguish between traditional insurers and those that carry out NTNI activities? If yes, please explain where such a distinction would be appropriate (for example, in relation to powers, resolution planning and resolvability assessments) and the implications of that distinction.

Yes, such distinction should be made once IAIS and industry have properly defined the term NTNI. It is only firms with the latter activities (regardless whether designated or not) to which the Insurance Key Attributes should apply.

The application of the Insurance Key Attributes should, however, not depend solely on the question whether a certain activity is NTNI but whether it could ultimately pose a systemic risk to the financial system. Therefore the applicability of the Insurance Key Attributes should depend on a two stage test:

- (i) Firstly, does the activity qualify as NTNI (as defined by IAIS and industry)?
- (ii) Secondly, is the respective insurer conducting the NTNI activity on such scale that financial shocks from such activities could pose a risk to the entire system (either because of the scale of the activity itself and/or because such activities could threaten the viability of the entire insurance group a collapse of which would in turn threaten the entire financial system).

Only if both questions are answered with "yes" the Insurance Key Attributes would apply and the respective insurer would have to demonstrate that the systemic activity is managed/set up in such manner that it does neither pose a risk to the entire financial system nor the group in case a collapse of the group would threaten the entire financial system (e.g. because the respective activity is ring-fenced).

24. Are the additional statutory objectives for the resolution of an insurer (section 1) appropriate? What additional objectives (if any) should be included?

We question whether the additional objectives are appropriate objectives for global regulation at FSB level:

- While we agree that the **protection of policyholders** should be a statutory objective of a general resolution framework, we do not believe it should be one of the primary objectives of a systemic risk regulation regime. An international body like the FSB should focus on threats to the global financial system. If understood as an aim in itself, policy holder protection seems to be a local issue falling out of the global mandate of the FSB.
- Preventing “too big to fail” and in consequence taxpayer bailout is a key objective of any global systemic risk regulation. Avoiding taxpayer losses caused by a political decision to prevent policyholders who have chosen an unstable insurer to suffer any loss, is not. The same applies with regard to the establishment of policyholder protection schemes. Such schemes may, in certain markets, be a very sensible solution but it is for local politicians (or the industry itself on a voluntary basis) to decide whether or not to establish them.
- Finally, the definition of “vital economic functions” in Section 1.2 needs further consideration in an insurance context, as there needs to be a focus on activities which might genuinely impact the stability of the financial system. If the concept of vital economic functions is interpreted too widely, we see the risk that resolution powers will be applied to business lines that do not require protection specific systemic risk related focus. Similarly, “risk transfer, risk pooling and the pooling of savings” cover most insurance activity. This would seem to imply that all insurance contracts are critical, which is certainly not the case. If the definition is left as it is, the distinction between what is systemically relevant and what is not will be lost.

25. Is the scope of application to insurers appropriately defined (section 2), having regard to the recognition set out in the preamble to the draft guidance that procedures under ordinary insolvency law may be suitable in many insurance failures and resolution tools are likely to be required less frequently for insurers than for other kinds of financial institution (such as banks)?

- The scope of application should make it very clear that the Insurance Key Attributes are minimum standards that do not have to be implemented if local or regional risk-based prudential standards together with applicable insolvency law achieve the same means. In Europe, any new resolution instrument must be closely aligned with new risk-based frameworks such as Solvency II. Anything else would, in case of EU member states, immediately contradict the new regulation which will (partially) apply from 01 January 2016 onwards (with certain risk-based components already being phased in 2014 and 2015). So far neither politicians nor supervisors have been able to explain why Solvency II as a highly sophisticated, risk-based system should not be sufficient to deal with (potentially) systemic activities.
- Moreover, with respect to the identification of the relevant resolution authority, the Insurance Key Attributes currently fail to distinguish between (additional) powers to be granted to the insurance regulator acting as administrative insurance supervisory body on the one hand and additional instruments that are made available in connection with an insolvency procedure under the control of an insolvency court on the other. Such distinction is key to ensure compliance with the rule of law as many of the suggested restructuring measures (e.g. the measures regarding restructuring of liabilities (cf. 4.4. (v)-(viii) Insurance Key Attributes) significantly encroach on ownership rights and go beyond of what is currently permissible in many jurisdictions.

26. Does the draft guidance (section 4) adequately address the specific considerations in the application to insurers of the resolution powers set out in KA 3.2? What additional considerations regarding the application of other powers set out in KA 3.2 should be addressed in this guidance?

Our key concern is that the criteria for non-viability (which is the precondition for entry into resolution) set out in section 4.1, are too vague and lack a thorough consideration of the long-term perspective of an insurance company. It remains unclear at which stage regulators should assume an „unacceptably low probability” of due and full payments to policyholders. The distinction between viability and non-viability is very important for insurers in crisis situations. As a general rule, there is a full range of recovery options available to regulators which deserve preferential consideration before contemplating resolution procedures. Given the considerable extent of discretion attributed to regulators, there is an immediate concern that regulators are tempted to prematurely step into resolution although there may be reasonable potential for recovery measures in order to maintain the viability of an insurer.

27. Does the draft guidance deal appropriately with the application of powers to write down and restructure liabilities of insurers (paragraphs 4.4 to 4.6)? What additional considerations regarding the application of ‘bail-in’ to insurers (if any) should be addressed in the draft guidance?

In addition to the comments of Insurance Europe (to which reference is hereby made), we would like to highlight the following:

- The measures for restructuring of liabilities (4.4. Insurance Key Attributes) proposed under 4.4.(v)-(viii) encroach on ownership rights and go beyond what is currently permissible for insurance **supervisors** in EU jurisdictions. It appears that such powers may (if at all) only vest with an (insolvency) court.
- As outlined in 5.1. Key Attributes, protections provided under the constitutions of jurisdictions based on the rule of law must be strictly respected. This applies in particular to the resolution powers to be granted to resolution authorities (4.2. Insurance Key Attributes). 5. Key Attributes suggests to award damages to creditors who – as a result of the proposed measures - would get less than in a regular insolvency procedure. This is not sufficient to address legal concerns.
- The proposed handling of the pari-passu principle (5.2. Insurance Key Attributes) is not compatible with fundamental principles of law as far as it proposes the creation of subclasses of existing policyholders. In order to maintain legal certainty and confidence of market participants, any collateral arrangements in place at the time of resolution of an insurer (including the insurer’s restricted assets) should be strictly respected.
- With regard to applying the bail-in tool in an insurance context, we believe that bailing in bondholders may under certain circumstances be an additional instrument to allow for an orderly resolution of an insurer. Regarding the **policyholder side** cf. our comments under Q 28 below.
- Section 4.4(v) Insurance Key Attributes: All that conversion to a lump sum achieves is the crystallisation of the liability. Liabilities of insurers, particularly of annuity payments, fall due over a long period of time. This considerably mitigates the systemic relevance of insurers, as it allows ample opportunity for management action to improve the insurer’s position. Crystallisation of the liabilities removes this possibility. We are also concerned by the power to settle insurance obligations by payment of a proportion of estimated present and future claims (section 4.4(vi) Insurance Key Attributes). In many situations, the full extent of future claims is unclear *on an individual basis* and so it wouldn’t make sense for the resolution authority to seek to settle obligations in advance. To the contrary it would lead to cash outflows in times where liquidity maybe of paramount importance..

- We see little purpose in the conversion of one type of insurance liability into another (4.4(vii)). Policyholders that sign out “with profits” or participation contracts accept a different relationship with their provider from those that sign a unit-linked contract. It is unclear to us how changing this would serve to facilitate the resolution of an insurer.
- Care should be taken not to trigger a systemic impact on the reinsurance industry by the measures envisaged under 4.4 (viii) and 4.8 with regard to inward reinsurance contracts.

28. Is it necessary or desirable for resolution authorities to have the power to temporarily restrict or suspend the exercise of rights by policyholders to withdraw from or change their insurance contracts in order to achieve an effective resolution (paragraph 4.9)?

It seems appropriate that a supervisor may use this power when an insurer is still viable, in order to mitigate perceived risks relating to the liquidity of insurance liabilities.

Moreover, we would like to stress that *as a matter of ultimate last resort* also the restructuring of liabilities towards policyholders (e.g. interest guarantees given) including adjustments to the technical provisions and the (restricted) assets covering such provisions should be possible for the competent authority prior to a winding-up of an insurer under stressed conditions. In this context we would like to observe that the above tools already exist in many jurisdiction including EU member states. Such national / regional provisions should be recognized by the FSB.

29. Are there any additional considerations or safeguards that are relevant to the treatment of reinsurers of a failing insurer or reinsurer, in particular to:

- (i) *the power to transfer reinsurance cover associated with a portfolio transfer (paragraphs 4.7 and 4.8); and*
- (ii) *the power to stay rights of reinsurers to terminate cover (paragraph 4.10)?*

Section 4.10 Insurance Key Attributes proposes that the resolution authority should have the power to “stay any right to no longer reinstate reinsurance cover upon payment of a premium”. This concept would require that as a general rule, reinsurers do have the obligation to reinstate reinsurance against payment of a premium which is not the case.

30. What additional factors or considerations (if any) are relevant to the resolvability of insurers or insurers that carry out particular kinds of business (section 8)?

We see a risk of overlap between Crisis Management Groups and Co-operation Agreements on one side and existing supervisory colleges and agreements on the other. In any case, we believe that to ensure a uniform approach we believe that the presence of the home country supervisor is of utmost importance and home-country supervision should be strengthened, as the prevailing national supervisor is best familiar with the whole insurance group and especially any systemic impact, the group may have.

31. What additional matters (if any) should be covered by recovery plans or resolution plans for insurers or insurers that carry out particular kinds of business (section 9)?

There are five principles which any recovery plan for insurance groups should follow:

- (1) A group recovery plan should be sufficient and prevail over any requests for setting up also national plans for subsidiaries, as most of the recovery measures concern the whole group, e.g. intra-group capital injections. A myriad of local recovery plans would not only be confusing but would mean above all a lot of unnecessary bureaucracy without any added value.
- (2) The plan should be set up including companies making up for a substantial part of the group's total assets and operating profits (including all non-traditional and non-insurance businesses), so as to include the most important subsidiaries and businesses, but just to avoid over-complexity and refraining from non-productive odds and ends. A broader scope would not lead to any new different recovery options and therefore neither impact the shape nor the contents of the Recovery plan.
- (3) The recovery options should be "effective", as only measures of a certain size may be powerful in a crisis scenario, e.g. measures with an impact of > 1 bn. € each.
- (4) The scenarios are primarily basis for the identification of key recovery measures and for the test of recoverability. The modeled crisis scenarios should be restricted to few meaningful scenarios, i.e. two systemic stress scenarios (a rapid and a slow scenario, like e.g. a Euro crisis scenario and a prolonged low interest rate environment) and two idiosyncratic stress scenarios (also a rapid and a slow scenario). A further increase of scenarios would not lead to identification of additional/ different key recovery options, as the number of large scale recovery options is anyhow limited.
- (5) Data privacy has in any case – punishable - to be secured – be it when collecting data for designation or sharing the recovery plan in the Crisis Management Group, where interested parties of the most important countries for the prevailing group are represented.

32. Are the proposed classes of information that insurers should be capable of producing (section 10) feasible? What additional classes of information (if any) should insurers be capable of producing for the purposes of planning, preparing for or carrying out resolution?

Also the resolution plan should generally rely on information already available at local level: Section 10.10 (ii) on "actuarial assumptions used for calculating insurance liabilities and an independent exit actuarial value of technical provisions" is an example for this: If this doesn't correspond to technical provisions as calculated for Solvency II purposes, it would add one more valuation basis to complete and the burden of this requirement would thus be too heavy. Solvency II valuation principles should therefore be acknowledged.

33. Does this draft Annex meet the overall objective of providing sector-specific details for the implementation of the Key Attributes in relation to resolution regimes for insurers? Are there any other issues in relation to the resolution of insurers that it would be helpful for the FSB to clarify in this guidance?

We are very much concerned about the paradigm shift the FSB seems to have undertaken in two regards:

- Embarking on systemic risk regulation the original question the FSB asked was whether there will be domino effects if a financial institution collapses. Once it was clearly established that this would not happen in the traditional insurance business, the definition appears to have been widened to whether there will be major socio-political effects if the private annuity benefits of millions of customers are reduced. The regulation of such socio-political aspects however, clearly falls outside the mandate of the FSB as it is hard

to see how such aspects could pose a risk to the global financial stability. Potentially even more severely, it may lead to a competitive disadvantage for large insurer. If socio-political considerations should become the anchoring point regulation ensuring a level playing field would have to apply to all insurers, irrespective of size.

- The FSB seems no longer to concentrate on properly defining systemicness in NTNI but on ensuring the viability/maintenance (in both recovery and resolution scenarios) of traditional business. This approach is also difficult to align with the FSB's mandate and could encroach significantly on the freedom of entrepreneurship (organization of an insurance group and the synergies and benefits derived by economies of scale) and due risk diversification in large insurance groups.

Overall, we believe it is essential that the FSB clearly focuses on measures / tools to address and mitigate systemic risk (defined by the FSB as the risk of a disruption to the flow of financial services that is (i) caused by an impairment of all or parts of the financial system and (ii) has the potential to have serious negative consequences for the real economy). All other issues should be left to national / regional competent authorities.

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