FSB Draft Implementation Guidance: Resolution of Insurers
Questions for consultation

Insurance Europe welcomes the opportunity to respond to this consultation by the FSB on the implementation of the *Key Attributes of Effective Resolution Regimes* to the resolution of insurers. We understand that in the wake of the financial crisis, there is a need to assess whether financial institutions other than banks are prone to generate systemic risk and to discuss what measures are necessary to prevent their potential failure from impacting financial stability. Furthermore, we believe it is legitimate to consider the question of resolution of insurers in this context, as long as the solutions devised in response are proportionate to their objectives and based on the unique characteristics of the insurance business model.

Insurers have a unique business model, very different from that of banking

Insurers benefit from an extended time horizon because their liabilities can fall due over decades and, as a result, the risk of a "run" is very limited. Because there is no maturity mismatch between assets and liabilities in the case of an insurer, strong connections (in the form of lines of credit) with other financial institutions are not necessary. The limited risk of contagion in case of an insurer's failure is also the result of the lack of close business relationships between competing insurance companies. These different characteristics of the insurance business generally allow considerable time for management action to be taken with a view to achieving an orderly resolution, over a long period of time.

We are concerned that the Draft Implementation Guidance in its current form fails to adequately adapt the Key Attributes to the specifics of the insurance business model. The concepts of recovery and resolution are treated here as if they were identical to the banking business and no consideration is being given to the industry's unique characteristics presented above. Applying a banking-inspired resolution framework to the insurance sector will have a potentially detrimental effect on financial stability and the protection of policyholders.

Against this background, Insurance Europe would urge the FSB to reassess its guidance in order to ensure that it meets the specific characteristics of the insurance sector, which is currently not the case in many instances, as developed in more detail below. As an example, we do not agree with the assumption that existing tools such as run-off and portfolio transfers may be inadequate to cope with a "sudden deterioration" in the viability of a large, complex insurance group.

The scope of the draft guidance is unclear

We are also concerned by the fact that the scope of the draft guidance is unclear. The recommendations provided here are in many respects very general and not related to systemic risk. In particular, the fact that criticality is separated from the assessment of systemic risk and added as a separate consideration in this guidance is not helpful, as it potentially extends the scope of the recommendations to all insurance activities, irrespective of whether their failure could give risk to a systemic event.

The introduction of new terms like "vital economic functions", "essential and systemically important functions" and "critical types of insurance policies" shifts away the focus from dealing with systemic risk 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, which is specifically entrusted with focusing on risks to the global financial system.

Against this background, Insurance Europe strongly believes that the FSB should make it clear that its recovery and resolution planning requirements should be aimed at those rare cases where systemically relevant activities undertaken by an insurer (regardless whether designated or not) might threaten its viability and the rest of the financial system. Otherwise, the regime will be highly disproportionate to the potential risks and would thus impose unnecessary costs on both policyholders and insurers and contradict level-playing field considerations.

Finally, the FSB guidance would overlap with existing insolvency regimes at local level, which have proven to be adequate for the resolution of insurers. An alignment of existing insolvency regimes with the FSB guidance would raise a number of complex legal issues and constitutional constraints at national level, as this would require extensive legislative change across jurisdictions. Some of the proposed changes touch on fundamental rights of creditors and principles of contract law and, as such, will be controversial in a number of countries.

Answers to consultation questions:

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?*

In general, we believe that the guidance fails to adequately adapt the Key Attributes (which address the resolution of banks) to the specifics of the insurance business model. The problem is, in our view, not that the powers specified here are not sufficient, but that many elements presented in the guidance are unnecessary and - for some - potentially detrimental to financial stability and the protection of policyholders.

The proposed guidance draws attention to the systemic consequences of an insurer's failure, without recognising that this is a very rare occurrence and that, more importantly, the systemic relevance of such an event is limited due to the low level of interconnectedness and the high degree of substitutability of the sector. Consequently, the regime is highly disproportionate to the potential risks and would thus impose unnecessary costs on both policyholders and insurers. Run-off and portfolio transfer will deal with most cases of failure of an insurer and we welcome the fact that the guidance recognises this.

We would further point out that regulations have natural limitations and that resolution powers are no exception to this rule. Awarding powers "sufficient for the effective resolution of all insurers" is much too ambitious an objective, given that unforeseen situations can always arise and one simply cannot devise powers to address all possible contingencies. We fear that attempting to do so will result in a regime that interferes unnecessarily in the activities of healthy insurers.

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.*

This draft guidance should not be aimed at traditional insurance activities, which are not systemically risky (on the contrary, they provide a significant measure of financial stability due to their focus on long-term investment). The draft guidance should only apply to those insurers that undertake systemically relevant activities on a scale that might threaten their viability and the rest of the financial system. In addition, "systemically relevant activities" should not be equated with NTNI; just because an activity is NTNI doesn't mean it's systemically important. We would furthermore like to point out that, since an agreed upon definition of NTNI activities still does not exist, the boundary between NTNI and traditional insurance activities is unclear and likely to remain unclear.

When envisaging different measures for insurers conducting NTNI activities, it is important to keep in mind that it is not the presence of NTNI activities alone that makes an insurer systemically relevant, but the relative size of these activities as a proportion of the insurer's business as a whole. NTNIs would need to be of a size sufficient that financial shocks from those activities could pose a risk to the insurer's viability. Even then, the size of the NTNI activity would need to be assessed relative to the financial system to determine if its failure would pose a systemic impact. Therefore, before determining the scope of the draft guidance, it is important that consideration is given to whether an insurer's conduct of NTNI activities is of potential systemic significance.

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

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 (Section 1.1). An international body like the FSB should focus on threats to the global financial system. If understood as an aim in itself, policyholder protection seems to be a local issue falling out of the global mandate of the FSB. In addition, we would point out that once an insurer has failed, there is a limit to the extent that resolution powers can protect policyholders from resulting consequences, as securing full continuity of insurance coverage and payments may be prohibitively expensive. It would thus be ill-advised to over-promise in this context, especially because a slight limitation of coverage would help prevent the moral hazard which arises when policyholders are absolved of all responsibility over their choice of insurance company.

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 financial system. The current enumeration in this section does not provide this focus. If the concept of vital economic functions is interpreted too widely, we see the risk that resolution powers will be needlessly applied to business lines where systemic risk cannot originate. We notice that "risk transfer, risk pooling and the pooling of savings", as referenced in the paper, will 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 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)?*

We believe that in most cases existing insolvency law regimes will be adequate for the resolution of insurers (including for most failures of G-SIIs), and that therefore new tools should only be introduced where there is no existing equivalent method of achieving the same intended outcome. The draft guidance should only apply to those insurers that undertake systemically relevant activities on a scale that might threaten their viability and the rest of the financial system.

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?*

Entry into resolution

We believe that the criteria for any intervention need to be more clearly and tightly defined than they are in this draft guidance. In particular, we would stress that entry into resolution should not occur before the insurer has reached the point of non-viability. A premature entry into resolution would rule out a number of recovery options that might produce a better outcome for the insurer and its policyholders (including run-off and portfolio transfer). While an insurer is balance sheet solvent, it should be possible to address it as a viable concern, with the encouragement of its supervisor where necessary. On the other hand, we agree that entry into resolution needs to happen before an insurer is balance sheet insolvent, as a formal "wind-up" would yield suboptimal outcomes for policyholder protection and continuity of cover. The focus of resolution should in any case be on those actions that are necessary where the firm is no longer viable.

Supervisors need to be clear on the differences between "viability" and "non-viability" and which of the two stages they are seeking to address with each recommendation they formulate. This will help to clearly distinguish actions that can be taken by an insurer and supervisors as a viable concern and actions that may be taken by the appropriate resolution authority once an insurer is deemed to be no longer viable. Furthermore, given the long term nature of the insurance business and the continuum of actions that can be taken to address a failing insurer, there should be a clear distinction between the scope and purpose of recovery plans and resolution plans. In our view, this would mean that:

- Recovery planning should be aligned to the management and supervision of an insurance group as a viable concern; and
- Resolution plans should address the remote situation where an unpredictable event has led to the failure of an insurer. Therefore, the question that resolution plans should seek to address is how policyholders' interests can be best protected in the unlikely event that an insurer reaches the point of non-viability.

The extended time horizon of insurers also means that insurers' liabilities can fall due over decades, allowing for considerable time for management action to be taken to restore the situation. For the same reasons, arriving at a decision over the probability that an insurer in difficulty requires resolution will also take time.

Commenting specifically on the FSB's suggestions, our view is that pre-defined triggers for entry into resolution are not appropriate, as an assessment of when an insurer's liabilities exceeds its assets requires significant judgment on the part of the resolution authority (this is because asset values fluctuate and so too do liabilities which are merely best estimates of expected claims/maturities rather than certain amounts). Importantly though, such judgement should take full account of the time available before liabilities have to be met and entry into resolution should not happen before all possible recovery options have been exhausted. Ideally, the authorities should be able to explain in public why entry into resolution provides a better outcome for policyholders or financial stability and their decision should be subject to judicial review.

Indicator (v), involving a judgment that entry into ordinary insolvency or the application of run-off or portfolio transfer powers would not be adequate to the situation, is an extremely important point, but requires refinement and strengthening to prevent the inappropriate use of powers. This indicator suggests that run-off and portfolio transfer are different in nature, and need to be considered separately from the other resolution powers mentioned in the document. We believe that they should be considered together, as tools available to the resolution authorities once an insurer has entered resolution. The first step should be a determination by the authorities that the insurer should be resolved – subject to the considerations set out earlier in this section. The next step should be deciding which resolution tools should be used, including run-off and portfolio transfer; these decisions may take place over a period of time, and may change as external circumstances alter.

We would also suggest that stronger tests and disincentives for the authorities to use powers going beyond run-off and portfolio transfer are needed. For example, approval of the Courts might be required for use of the other powers. Finally, the point at which an insurer enters resolution should not remove all risk from policyholders as this would create moral hazard. However, potential losses to policy holders should be limited.

Choice of resolution powers

We agree with section 4.2 on the choice of resolution powers. We would however point out that some form of oversight is required to ensure that the resolution authorities have indeed used powers suitable for the event. As *ex ante* judgments are difficult, some form of *ex post* assessment may be helpful (e.g. an examination by the Courts whether the actions of the authorities were reasonable in the given circumstances).

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?*

Control, manage and operate the insurer or bridge institution

In a situation where the insurer is no longer viable, the power to continue to carry on some of the insurer's business, for example making payments to annuitants would be consistent with policyholder protection. However, the aim should be to establish appropriate adjustments in value, where required, as soon as practicable to prevent conflicts of interests arising between different policyholder groups.

We agree that control, management and operational powers are necessary. We would point out though that in insurance, establishing a bridge institution is another means to undertake a portfolio transfer. Given the long-term nature of insurance liabilities, the same time impediment that exists in banking does not exist in insurance, so the use of a bridge institution as a quick or interim solution is not necessarily in the best interest of policyholders. This would be better served through a transfer to an existing, well capitalised insurer able to exercise more freedom over its investment strategy.

Restructuring of liabilities

The key aspect that we would like to emphasize in responding to this section is that the resolution of an insurer takes place over a long period of time notably because a "run" or a liquidity crunch is unlikely to occur in insurance. The extended time horizon of insurers means that their liabilities can fall due over decades, allowing considerable time for management action to be taken to restore the situation.

Applying the bail-in tool in an insurance context is unnecessary in our view. If authorities are looking to adjust creditor liabilities, as with writing down policy benefits, corporate restructuring arrangements already exist and they require creditor and court agreement. Since insurers' resolution happens in an extended period of time, this allows for such an agreement to be arrived at. We do not believe that the power to restructure liabilities should fall to regulators alone, as this encroaches on ownership rights protected under almost all jurisdictions as fundamental rights, and so Court approval would be needed. As above, in view of the extended timeline of insurance resolutions, there is time for the approval of the Courts to be sought.

Given the potential impact of some of the resolution powers provided by the draft guidance (e.g. reducing annuity rates), we believe that authorities' decisions will face legal challenges in any case.

Furthermore, we would point out that bailing in bondholders would make a very mall contribution to the resolution of insurers, since the latter finance themselves primarily through up-front premiums and investment returns.

- It is not obvious what conferring the ability to convert an annuity into a lump sum payment (4.4(v)) aims to achieve. If it is clear that the company will not be able to make future payments, but not clear what level of haircut needs to be applied to achieve sustainability, then it will not be clear what level of lump sum would be appropriate either. All that conversion to a lump sum achieves is the crystallisation of the liability. As we pointed out at the beginning of our response, the liabilities of insurers, particularly of annuity payments, fall due over a long period of time. We consider this to be one of the factors that considerably mitigate 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 (4.4(vi)). In many situations, the full extent of future claims is unclear and so it wouldn't make sense for the resolution authority to seek to settle obligations in advance. In the vast bulk of insurance failures, time will allow for detailed actuarial valuation.

- 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.

- While resolution authorities should not be obliged to identify all potential creditors they should make every effort to do so (4.5 and 4.6).

Respect of creditor hierarchy and creditor status of policyholders and pari passu

The principle of respect for creditor hierarchy is right, but requires further elaboration to ensure that the rights of bondholders are met. Particularly in the case of groups, where bondholders may depend on different legal entities, the creditor hierarchy requires careful consideration. Any departure from the *pari passu* principle will deter bondholders from investment in insurers. Therefore any deviation from the principle should only be taken in circumstances where adherence to *pari passu* would produce perverse or blatantly unfair results. Finally, we agree with the existence of the "no creditor worse off" safeguard.

Funding resolution

We are concerned about the requirement in section 6 that jurisdictions should have in place privately-financed policyholder protection schemes that can assist in securing continuity of insurance portfolio and compensating policyholders or beneficiaries.

Insurance Europe believes that there is no case for making policyholder protection schemes compulsory in all jurisdictions. At EU level, the strict solvency regulations, together with competent supervision, provide already for an adequate level of policyholder protection. In addition, some jurisdictions have decided not to introduce insurance policyholder protection schemes because of the nature of their local insurance market, such as the market concentration which would prevent the policyholder protection schemes from functioning effectively, or because of other significant side-effects that policyholder protection schemes may entail, including the moral hazard for insurers, policyholders, policymakers and supervisors, the possibility of arbitrage, or simply because there is no need for setting up such a scheme. Indeed, there are various ways (alternative to policyholder protection schemes) to add protection for policyholders.

Where policyholder protection schemes exist, we believe that jurisdictions should retain discretion on whether their schemes should ensure business continuity through portfolio transfer and/or compensation. In practice, the functions that a policyholder protection scheme performs differ between jurisdictions, since they may depend on many factors, such as the scheme coverage and funding, the related costs, the national winding-up system, the other protection mechanisms in place, etc.

Finally, we suggest deleting the reference to "privately-financed" as this should not matter where policyholder protection schemes exist.

We would thus propose the following rewording:

> **6.1.** Where jurisdictions ~~should~~ have in place ~~privately-financed~~ policyholder protection schemes ~~that can~~, the latter may assist in:
>
> (i) Securing continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or third party or use of any other resolution powers; and/or
>
> (ii) Compensating policyholders or beneficiaries for their losses in the event of a wind-up or liquidation.

Portfolio transfer

We agree that a power to transfer portfolios is needed. However, a power to reduce the value of contracts is a completely different matter, and should be subject to the approval of the Courts along with all other powers that involve the confiscation of property. The inclusion of this provision seems to be based on an assumption that speed is a critical factor in resolving an insurer; as highlighted previously, the timing characteristics of insurance should allow a valuation to be prepared before a transfer is agreed.

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 and useful to us 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. Most insurance policies impose penalties for early surrender of policies, and in most cases this has proved effective in preventing a run. It is however possible that at the news of an insurer's failure policyholders will be unaware of their rights, and may act precipitately against their own interests. This seems an effective way of addressing this remote risk.

We would also point out that if supervisors hold such a power, the weight given to the assessment of liquidity of insurance liabilities as a measure of systemic importance should be reduced.

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)?*

With regard to commercial agreements with counterparties (i.e. reinsurers), the integrity of the commercial agreement should not be undermined. A retroactive change in contract terms could destabilize the ordinary course of the going concern business. In particular, the measures proposed under 4.4 (viii) and 4.8 in respect of inward reinsurance contracts could have an impact on the reinsurance industry. Moreover, Section 4.10 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. Therefore we do not consider that the power set out in 4.10 is necessary.

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.

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)?*

We would like to reiterate our assessment that many elements presented in the guidance are at least unnecessary and at most potentially detrimental to financial stability and the protection of policyholders. Hence, we don't believe that additional matters should be covered, as far too much overlapping material is already included.

Resolvability assessments

The separate purpose of resolvability assessments, resolution plans and recovery plans is not obvious to us. If this isn't clarified, there will be overlap and confusion between the exercises. As mentioned before, there is a need for clarity with respect to the differences between viability and non-viability and which stage the resolvability assessment is seeking to address. The resolvability assessment should consider how, in the unlikely situation in which an unpredictable event has led an insurer to a point of non-viability that it cannot recover from, policyholders' interests can be best protected.

Given that the objective of resolution is to ensure policyholder protection and continuity of cover, where all other recovery actions have been exhausted, this would seem to point to the recapitalisation of the insurance entity. This may necessitate a change of ownership of an insurance entity where parental support is either unviable or unavailable. As a result, the proposed approach is not feasible to a large and complex group where legal entities are not set up according to business lines. Applied vigorously, it could remove any synergy/diversification benefits in a holding structure and impede the fungibility of assets.

Therefore the resolvability assessment should, in our view, focus on:

- Sources of support;
- Enforceability of intra group agreements;
- Transferability of service agreements where services are provided by other parts of the group, or contracted by other parts of the group;
- How ownership would be structured for the entity where it is recapitalised without group support, whilst maintaining respect for creditor hierarchy, so that they can be reimbursed for their losses from future gains.

The requirements on resolution authorities in paragraph 9.2 need to be modified, or they will produce an outcome that will severely restrict the activities of insurers in the normal course of business, to an extent that is not justified when balanced against the mitigation of damage in the relatively rare event of an insurer's failure. For example, it would be prohibitively expensive to ensure continuity of insurance coverage in all cases.

- Any assessment of the availability of a transferee or purchaser (9.3(i)) is unlikely to be valid in the circumstances of resolution.
- Solvent run-offs (9.3(iv)) need to avoid a situation where earlier maturing policyholders become subordinated to later maturing policyholders. Both points apply just as much to healthy and failing insurers. We believe that whether or not an insurer is in a solvent run-off, it will be subject to prudential regulation as a going concern and will need to be capitalised to meet its obligations to policyholders as they fall due. Therefore, the risk that maturing policies will not receive their benefits in full in such situations is very low.
- Requirements on management information and documentation (9.3(v)) have the potential to be very burdensome and costly, and should be strictly proportionate to the risk.
- We are concerned by the requirement (9.3(vi)) to align business units with legal entities. This reaches deep into the organisation of an insurer, which should be for management to determine. There is a risk that this could leave to an unnecessary and artificial proliferation of legal entities. All that is required is

an assessment that the legal structure of a group will not act as an obstacle to its resolution in the unlikely event of failure. The key here is not the corporate structure, but the nature of service agreements, so that services provided to a legal entity could continue if it were separated from the group.

- As previously mentioned, applying the bail-in tool in an insurance context is unnecessary in our view. If authorities are looking to adjust creditor liabilities, as with writing down policy benefits, corporate restructuring arrangements already exist and they require creditor and Court agreement. Since insurers' resolution happens in an extended period of time, this allows for such an agreement to be arrived at.
- Notwithstanding the fact that there is still no agreed upon definition of NTNI activities, the requirement for their structural separation from traditional insurance (9.3 (viii)) raises the same concerns as the requirement to align business units with legal entities. This requirement seems to have been read across to the resolvability assessment from the measures to reduce or mitigate systemic risk – where there are major doubts about its efficacy - without considering its purpose in this context.
- The examination of intra-groups transactions (9.3 (x)) is a key element of any resolvability assessment. However, if carried too far, this analysis risks immobilising the flow of capital around groups and exacerbating the current trend towards capital fragmentation. Consequently, the measures required as a result of this assessment need to be strictly proportionate to the risks identified, and weighed against the impact they would have on the availability and cost of insurance. The focus should be on the enforceability of intra-group transactions, which should be considered as part of going concern management actions and recovery scenarios.
- The significance of the requirement 9.3 (xiii) needs further exploration. The definition of "surplus asset" should first be agreed upon. In principle, surplus assets are for the group to allocate as they see fit, and any restriction of this would have a very severe impact. We believe the FSB should expand on this point of guidance and specifically state that authorities should not ring fence assets in jurisdictions in a manner that could damage diversification of risk within an insurance group through restricting fungibility.
- An assessment of the impact on economic activity as a result of disruption to continuity of insurance cover (9.4 (i)) is a legitimate requirement, and indeed the possibility of hardship to households should be given greater prominence in the analysis. However, this assessment needs to be kept in proportion. The failure of an insurer will inevitably show some level of disruption and discontinuity. The question is: how great would that disruption and economic hardship be not just for individual policyholders but for national, regional and global economies, and how quickly could insurance cover be restored? Every analysis of previous insurance failures shows that both new capital and the supply of expertise are restored relatively quickly. Cover may not always be available at the previous price, but that is usually because the failed insurer had artificially disrupted the market before its failure through persistent under-pricing and under-reserving. Such behaviour needs to be tackled by supervisors long before the point of resolution.

- We consider the likelihood of a policyholder run triggered by lack of confidence in other insurers (9.4(ii)) to be extremely remote, for reasons we outlined earlier in our response. Furthermore, this possibility can be mitigated by a power to suspend policyholders' surrender rights.

Recovery and resolution planning

Insurance Europe believes that the draft guidance treats the concepts of recovery and resolution as if they were identical in insurance as in the banking business. This is not the case, and much clearer thought is required on the purpose of recovery and resolution planning for insurers, given their different business model characterised by the extended time horizon of their liabilities.

The services that support insurance activities are readily substitutable in the market, with portfolios being transferable to alternate providers, and the interconnectedness between a particular insurance company and the rest of the financial system is limited. Consequently, the systemic risk that originates in insurance is much lower than in banking. This is why it would not be appropriate to base a recovery and resolution regime for insurers on the template used for banking. Indeed, applying a banking-inspired resolution framework to the insurance sector can actually be detrimental to financial stability and to the protection of policyholders.

The recovery and resolution framework presented by this draft guidance should apply to those insurers that undertake systemically relevant activities on a scale that might threaten their viability and the rest of the financial system.

In Section 10.1, the paper refers to the need for resolution regimes to apply to any insurer that could be systemically significant or critical if it fails. This extends the scope beyond the original definition of systemic risk as set out by the FSB in October 2009. That definition stressed the critical importance of the continued provision of certain financial services in the context of a systemic event which was defined as 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. We believe this is a good definition which needs to be maintained.

We do not consider that criticality should be separated from the assessment of systemic risk and added as an additional consideration. This potentially extends the scope to all insurance activities, irrespective of whether their failure could give risk to a systemic event. Whilst insurance activities may be critical to individual policyholders, bar in exceptional circumstances the failure of an insurer is unlikely to significantly impact parts of the financial system or have serious negative consequences for the real economy.

We agree that recovery and resolution plans (RRPs) must be tailored to the circumstances of each insurer. It is therefore essential that national supervisors are able to communicate the rationale for a firm's designation as G-SIIs and that the methodology supports an adequate identification of the systemically risky activities that cause an insurer to be designated as systemically important.

There are five principles which each RRP should follow:

(1) A group recovery plan should be sufficient and should automatically satisfy requests for setting up national plans for subsidiaries, as 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 unduly increase the regulatory burden without bringing any added value.

(2) The plan should be set up to include only the most important subsidiaries and businesses which making up for a substantial part of the group's total assets and operating profits (including NTNI businesses). A broader scope would not yield any new recovery options.

(3) The recovery options should be commensurate to the crisis scenarios they are seeking to address.

(4) The scenarios serve primarily as a basis for the identification of key recovery measures and as a recoverability test. The modeled crisis scenarios should be restricted to a few meaningful ones and an idiosyncratic one. Authorities should keep in mind that the number of large scale recovery options is limited, so using a larger number of tests would not help identify more recovery options.

(5) Data privacy has to be secured when collecting data for designation or when sharing the recovery plan in the Crisis Management Group.

The strategic analysis required for an RRP seems to be very similar to the requirements of a resolvability assessment and the different purposes of the two documents remain unstated. In particular, the definition of "essential functions" in paragraph 10.3 is extremely wide, amounting to a requirement to include most of an insurer's business. This would seem to imply that all insurance contracts are critical. This is inappropriate as the distinction between what is systemically relevant and what is not has thus been lost. There needs to be a focus on those activities that due to their size and/or market concentration could have an impact on the global financial system or real economy. The current description within this draft guidance does not provide this. For example, we notice that some of the proposed requirements for a resolution plan (actuarial assumptions used to calculate liabilities, review of asset quality and concentration) look very similar to the prudential requirements for an on-going insurance business.

- 10.10 (ii) notes that the plan should include the actuarial assumptions used for calculating insurance liabilities and an independent exit actuarial value of technical provisions. Supervisors should have an understanding of the assumptions used in calculating liabilities as part of their 'going concern' oversight of insurers. Therefore, it would seem unnecessary to include this within the scope of the resolution plan. As noted above, the plan should focus on the circumstances where an insurer is no longer viable, i.e. the assets will be insufficient as valued and monitored on an ongoing basis. It should also be noted that providing <u>all</u> actuarial assumptions used within a large Group would be impracticable as these would include mortality tables and numerous other assumptions, whose total volume in a large group is enormous. Another open question is the definition and purpose of "independent exit value of technical provisions": 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.

- 10.10 (vi) notes that the plan should contain a provision for continuity or an orderly winding down of any derivatives portfolio. Derivatives trading (in both OTC and central clearing environments) functions in such a way that almost any default event coming from an insurer (e.g. the non-payment of a coupon on issued bonds) could potentially trigger a wind-up situation for all existing derivatives in the insurer's portfolio, including those derivatives which are used for pure hedging purposes. For a stressed insurer, such a wind-up would only make things worse, as it would mean the insurer is left with no hedge in place. In a "normal" situation, as long as derivatives are there to hedge existing assets/liabilities, any positive/negative change in the derivative position is fully covered by a symmetric negative/positive change in the assets/liabilities which are being hedged so there's no economic reason for a wind-up. A correct approach which would limit the deterioration of the insurer's situation would be ensuring the continuity of derivatives which are meant to hedge existing assets or liabilities on the insurer's balance sheet. Thus, the derivatives pool should be bankruptcy-remote, ensuring that if the insurer goes through a default event (such as non-payment of coupon), this does not trigger a wind-up of the hedging derivatives included in the assets pool. Policyholders would thus continue to be protected against adverse market movements.

- 10.10 (vii) notes that the recovery plan should consider details on ceded reinsurance among the various legal entities and impact on the recovery levels. Reinsurance will be a factor in the valuation of liabilities. This is something that is already considered as part of the ongoing management and supervision of an insurer. Contracts of reinsurance between legal insurance entities should not be impacted by resolution if the aim is to provide continuity of insurance, through recapitalisation of the entity (preserving its legal identity).

- 10.10 (viii) notes that the plan should include an estimate of the outcome for each class of policyholder upon winding up the insurance entity. The value would depend on the available assets, of the insurer and market conditions that may affect those assets. Therefore, this is something that would be best estimated once a decision has been taken that an insurer should enter into resolution, rather than something that can be planned in advance. Given the objectives of resolution to protect policyholders and provide continuity of cover, a wind-up would seem to be an exceptional course of action only to be considered if recapitalisation is not considered viable. The plan should perhaps set out considerations that the resolution authority should take in this respect, rather than trying to predict in advance what uncertain future values may be.

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?*

Our assessment is that the data maintenance requirements are extremely burdensome and costly. We are not in favour of producing additional material for this purpose.

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?*

Overall, we believe that the guidance fails to adapt the Key Attributes adequately to the specifics of the insurance business model. The guidance rightly draws attention to the possibility of insurer failure, and to the possible systemic consequences but fails to point out that such failures are very rare, and the systemic consequences even less likely to materialise. As a result, the proposed regime is disproportionate to the risks.

No new regulation should be introduced without any prior assessment of whether or not existing measures are sufficient. In addition, a field test focusing on the potential effects for the regulated company, the clients and the markets should be performed. In case more possibilities exist to achieve a certain result, it is a generally accepted principle that the less burdening measure has to be taken.

To conclude, we would like to point out that there is a balance to be struck between financial stability and growth and, in our view this proposal does not achieve this. The document contains no impact assessment or cost/benefit analysis of the proposed measures. This is a major omission for such far-reaching proposals, especially because the G20 has explicitly asked the FSB to consider the impact of regulatory change on long-term investment.