



Association of British Insurers' response to:

FSB's Consultative Document: *Developing Effective Resolution Strategies and Plans for Systemically Important Insurers*

The Association of British Insurers is grateful for the opportunity to respond to this FSB consultation. We welcome the recognition of previous concerns raised by the insurance industry, particularly on the differences between banks and insurers and on the definition of critical functions.

Regarding the scope of this document, there are references made to both systemically important insurers and critical functions. It is important to recognise that designation of systemically important insurers and identification of critical functions are very different, and that policymakers should not mix up these two approaches. Furthermore, thought should be given as to how to ensure a level playing field for G-SIIs. There should therefore be a mechanism to ensure consistency is achieved globally.

We have set out our detailed comments below, but our key points are as follows:

- It is important to ensure flexibility for regulators on the application of resolution strategies and plans, on determining points of entry and on the definition of triggers.
- It should be recognised that run-off and portfolio transfer are the most preferred tools in a situation of insurance failure.
- Greater transparency is needed for firms on the resolution planning process and critical function designation.
- Substitutability is rarely an issue in the insurance industry.

We hope our comments are useful and would be happy to contribute further input or to provide clarification. Please contact Alisa Dolgova (alisa.dolgova@abi.org.uk) or Ruth Shin (ruth.shin@abi.org.uk) should this be required.

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?

The ABI is supportive of an approach whereby authorities identify institution-specific resolution objectives, as this would allow the particular activities considered to be important for maintaining the financial stability of each company to be taken into account. We do wish to highlight, however, that these institution-specific objectives should be transparent to the firm in question.

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 flexible approach for determining ‘points of entry into resolution’. We agree that it is better not to prescribe points of entry, but rather to allow authorities to decide upon what is most appropriate in a given situation, and not to be bound by a strategy determined at a certain point in time. The development of a preferred resolution strategy that best achieves the resolution objectives may depend on many factors such as the existing structure and business model, the need for recapitalisation, the necessity for preservation of diversification, or the degree of internal interconnectedness within the group.

We wish to emphasise the importance of proportionality in relation to the final line of **Section II.1**, where it states that if there are continued obstacles to resolution, authorities might need ‘to require firms to make changes to legal and business structures to address such obstacles and improve their resolvability’. As set out in a previous submission to the FSB in 2014 on critical functions,¹ insurers’ failure is managed over a long period of time, typically through run-offs (particularly for long-term business). Rather than failing suddenly and requiring a ‘weekend resolution’, insurers’ liabilities crystallise gradually over time, which allows for the implementation of a structured wind-down.

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?

In general we agree with most of the considerations in Section II and analysis in Section III and the comprehensive consideration of different kinds of resolution tools and different

¹ ABI (2014), [ABI response to FSB's Consultative Document 'Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services'](#)

business segments. We had a number of specific points we wanted to highlight in relation to both sections.

First, we wish to comment on the statement in **Section II** paragraph 2 which asserts that internal interconnectedness can lead to intra-group contagion. Intra-group contagion should not be exaggerated as insurers are not usually as heavily interconnected as banks. For instance, insurers maintain funds backing policyholder liabilities within entities that have the liability and there is usually no pooling of funding and liquidity, as may exist for banks. Moreover, levels of intra-group interconnectedness are variable and, where there is contagion, the group can work together to minimise the impact.

Second, we welcome the reference to Policyholder Protection Schemes (PPS) in **Section II.3**. This is a useful tool to help ensure a fully workable resolution strategy. We note from the consultation paper that the choice of preferred resolution tools may be affected by the existence of PPS or other policyholder protection mechanisms.

Third, in relation to **Section III.1.a** on life insurance we would caution against the emphasis in paragraph 3 on the need to 'secure continuity of cover' on the same terms and pricing. It may be that the reason an insurer is failing is due to underpricing or unsustainable guarantees. In this scenario, terms and pricing might need to be addressed in order to ensure continuity of cover.

Fourth, on substitutability, we welcome the line in **Section III.1.a** that 'most life insurance products are highly substitutable'. However, by contrast, in **III.1.b** in the final paragraph on P&C it discusses that, where policies are more 'complex and unique', authorities 'may consider examining whether there are structural factors that led to a lack of substitutability which may need to be addressed by policy action in other domains (e.g. competition).' We support the point that policy action in other domains could be beneficial to insurance companies. However, we would challenge the assumption that there is a lack of substitutability in P&C. In the insurance industry, where portfolio transfers are common, capital and expertise – the two key elements in insurance capacity – have in practice proved easy to replace. That a 'lack of substitutability does not appear to be an issue in the insurance industry' has been confirmed by the International Association of Insurance Supervisors in its Insurance and Financial Stability paper.² For example, the Bermudan market typically responds with 'classes' of insurers after each major event and pay-out to restore capacity.

² IAIS (2011), [Insurance and Financial Stability](#)

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?

In general we agree with the considerations set out in **Section II.2**. The categorisation of resolution tools into stabilisation and restructuring, wind down tools, and stay and suspension powers is a helpful distinction. However, the guidance should state more explicitly that run-off or portfolio transfer should be the most preferred tools. Regulators should only turn to more intrusive tools if there are clear reasons why run-off or portfolio transfers will not meet the resolution objectives. In many cases, rapid intervention will not prove a good reason for choice of resolution tools. Insurance failures happen over a long period of time, and even fast moving stress scenarios do not occur over a weekend. Forcing rapid action such as a fire-sale of assets or the crystallisation of the assets' current value (or liabilities' value in the case of liquidation) would be damaging.

We are particularly pleased to see suspension powers proposed as part of the resolution toolkit. This is an approach that has been used effectively in a number of countries, including for U.S. life insurers in the 1990s and Japanese life insurers in the early 2000s.³ Stay and suspension powers preserve value and can very often prevent the need to use more drastic measures within the resolution toolkit. The powers listed within this document are important but by no means all-encompassing. The example given relates to the 'cashing out' of annuities (we should stress this relates to variable annuities as opposed to UK payout annuities), but other examples would be a stay on switching, to prevent policyholders switching accounts, and also a stay on service or infrastructure contracts.

Lastly, on **Section II.2.b** we would caution against the use of liquidation and winding-up in all but exceptional cases of insurance failure. Liquidation will destroy value in a portfolio designed for buy to hold. Any such action would require court sanction. Even in the case of other unsecured creditors, it may be more desirable to defer payments at the first instance and perhaps convert to equity; run-offs would mean that, at a future point, more funds may become available to pay out. As above, it should be stressed that other tools such as run-off or portfolio transfer should be the most preferred tools, with liquidation as a last resort.

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?

We agree that this framework takes into account a variety of difference types of insurance business and that it will be effective, provided the final guidelines remain flexible and do not prescribe requirements that must be met.

³ The Geneva Association (2015), [U.S. and Japan Life Insurers Insolvencies Case Studies: Lessons learned from resolutions](#)

On reinsurance in **Section III.1.c**, we concur that reinsurance is subject to exposure limits in both directions because of the reasons provided in the paper. However, the degree of contagion and lack of substitutability on the same terms and price is limited. We are concerned by the line ‘in some cases, the highly specialised nature of the primary business means that very limited reinsurance alternatives are available.’ In the event that a reinsurer operating in highly-specialised business lines fails, expertise is not lost and capacity will still be present in the market so that coverage can be substituted within a reasonable timeframe.

Regarding financial market activities and investment products in **Section III.1.d**, we welcome the recognition that resolution authorities may need to take action to avoid ‘fire-sales’, for example the use of stay and suspension powers. However, we would note that an insurance resolution regime should not be designed around the unlikely scenario of a ‘fire-sale’. In contrast to banks, insurers do not typically engage in maturity transformation, and the duration of assets in an insurer’s investment portfolio is matched to the timing of its future underlying liabilities. Insurers’ stabilising and countercyclical role as long-term investors, for example in infrastructure and other long-term assets, was highlighted in a recent Bank of England’s discussion paper on procyclicality.⁴ Moreover, the additional benefits frequently offered by insurance products such as health cover/life insurance or guarantees, act as a disincentive for policyholders to surrender. All of this reduces the likelihood of fire-sales and, in fact, forcing a ‘fire-sale’ could be extremely damaging. Overall then, given that the majority of mainstream products are unlikely to experience fire-sales, it is important to apply caution in introducing certain requirements based on a minority of cases.

Finally, we wish to comment on the final paragraph of **Section III.1.d** on variable annuities. We are pleased by the suggestion of a temporary stay on ‘cashing-out’ annuities, as this may be a helpful tool in certain circumstances. However, we have a number of objections to the description in footnote 17:

- Where guarantees are provided on variable annuities (VA), all of them may not be guaranteed monetary amounts. In the case of minimum withdrawal benefits, the policyholder is given the right to take an annual guaranteed income that does not decrease due to the performance of the basket of VA assets chosen.
- The statement that a VA ‘tends to exit risky assets in bad times’ is not necessarily correct. Sales of risky assets held within variable annuities generally decrease in bad times as policyholder surrenders decline significantly during such periods, reflecting

⁴ Bank of England and Procyclicality Working Group (2014) [Procyclicality and structural trends in investment allocation by insurance companies and pension funds](#)

the increased value of the VA guarantee which the policyholder is likely to want to hold onto. Hence, the assertion that procyclicality is created as policyholders have a right to surrender is not accurate.

- It should also be noted that the policyholder assets are held in legally insulated separate accounts managed by independent sub-advisors. The Funds have their own independent Boards to protect the policyholder interests and the insurer cannot legally influence the fund management.

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 welcome the revised definition which defines critical functions as those functions that would be likely to have a material impact on the financial system and the real economy if they failed. We also welcome the statement that services which do not have a significant impact on economic and financial stability, or that can be easily substituted, should not be considered critical. We note, however, that the next step needs to be greater transparency to relevant firms as to why and how they have been identified as having a critical function. There needs to be a consistent approach at a global level to identify critical functions and critical shared services.

The method proposed for identifying critical functions is appropriate. We welcome the recognition that this takes place in a wider political and economic context, and we approve of the reference to a firm-specific analysis, taking into account the fact that critical functions vary by firm and jurisdiction. We would reinforce that, unlike banks, insurers' failure is managed over long time period meaning that critical functions are not suddenly withdrawn on resolution. Any response should therefore be proportionate, as unnecessarily onerous requirements could lower incentives for their provision and raise costs for policyholders. We would also reinforce the need for a clear process for critical function analysis. Regulators should agree with an insurer which areas the analysis should focus on, based on their experience of the business and company.

With regards to **Section III.2.c** on Criticality, we agree with the new approach of specifying through an objective what regulators wish to continue, whether it is simply payments falling due under cover written before resolution, or whether it is to continue to write new business. It is also helpful to have the recognition that resolution planning will differ as a result, dependent on the assigned category. On continuity of cover, we would also wish to highlight that there is a distinction to be made on life policies. If the objective is the continuity of existing cover, then policies can be run-off or transferred to a different insurer.

If the resolution objective is to continue to write new business, it is hard to envisage where a different insurer would not be able to meet policyholder needs. It may be that the new cover is not the same price or format. However, in many cases we would not aim to replicate legacy products.

In relation to critical shared services in **Section III.3**, we are content with the proposals here and welcome the clear linkage of critical shared services to identified critical functions. We also agree with the aim of ensuring continuity of shared services in resolution, and welcome the acknowledgement that this can be achieved in a number of ways, not limited to the examples given. However, we would state that in financial services it is important to recognise that insurance liabilities include a provision for ongoing maintenance cost and these would provide for future expenses.

Pertaining to **Box 3** on 'Arrangements to support operational continuity', in general we agree with the proposals on arrangements to support critical shared services, provided the current supervisory approach continues. However, we have a few points we wish to make:

- There is an issue of language to be addressed. The introductory line indicates that these are arrangements which 'could' be followed, however in subsequent points it is suggested that these are arrangements which 'should' be followed. These subsequent points ought to be amended to be consistent with the opening statement. In this way, it will be clear that these are considerations rather than mandatory requirements, and there is also a recognition that other considerations may be equally or more appropriate, dependent on the circumstances of the insurer.
- On 'Financial resources' it is important to recognise that insurers already have provisions for expenses in calculation of their liabilities. It will be for the administrator to decide immediate funding priorities, such as ensuring that the third party continues to be paid (indeed we are not aware of any examples of when insurance administrators failed to pay external suppliers).
- We agree that clearly documented contractual arrangements and SLAs should be in place for intra-group and third party critical shared services for insurers with critical functions.
- We have some concerns on the issue of 'Governance'. The suggestion of potentially separate reporting lines for functions such as IT and HR could be costly and time-consuming.

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 would like to make a few comments on Section IV. In relation to **Section IV.1** on operational plans, we would emphasise the importance that these plans remain proportionate and transparent to firms. They should also be flexible, allowing authorities to take into account the circumstances of resolution. Insurance resolution does not have the same urgency as bank resolution, and tools such as portfolio transfer and run-off facilitate this longer term process. Authorities should therefore be in a position to adapt their approach and plans as the situation evolves.

With regards to triggers in **Section IV.3**, we welcome the fact that these are not fully defined, leaving the regulator sufficient flexibility to take appropriate action. We note that any pre-agreed triggers should be fully transparent to insurance companies.

We agree with the principle behind COAGs in **Section IV.4**. It is important that national authorities cooperate effectively in circumstances of cross-border resolution to ensure a common understanding of resolution measures.

Lastly, we have a comment in relation to **Section IV.5** on information systems and data requirements, in particular information concerning policyholder protection schemes. It will be necessary to factor into the plans the approach of the administrator of the PPS to establishing eligible claimants under the scheme, where there are eligibility criteria that will need to be satisfied by potential claimants. It will be difficult to identify policies that are eligible for compensation in advance, given that eligibility is defined at the time of resolution. Efforts should instead be focussed on improving/facilitating the process that would enable the identification of eligible policyholders in resolution (i.e. contingency actions).

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?

We have no further issues to raise.