

To: Financial Stability Board (FSB)  
From: National Association of Insurance Commissioners (NAIC)  
Date: January 4, 2016  
Re: Comments on FSB's Nov. 3, 2015 Consultative Document "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers"

The National Association of Insurance Commissioners (NAIC) has reviewed the Financial Stability Board's (FSB) consultative document on "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers" (the "consultative document"). The NAIC's comments on the eight questions on page iv of the consultative document are as follows.

**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 NAIC agrees that group-wide and domiciliary supervisors responsible for resolution should identify institution-specific resolution objectives. However, we believe that the consultative document should be augmented to include other considerations that are discussed below:

***Recognition of Actual Jurisdictional Authority as the Basis for Resolution Strategies and Plans***

The consultative document's introduction (pages 8-9) states that the guidance "assumes that the Key Attributes have been implemented. Where jurisdictions have not yet fully implemented the Key Attributes for the insurance sector, resolution strategies and plans should be developed on the basis of the powers and tools available under the regimes in force, and periodically modified to reflect subsequent developments." The determination of a preferred strategy (page 11) states that "CMG authorities should develop a preferred resolution strategy that is best capable of achieving the institution-specific resolution objectives given the structure and the business model of the insurer, the resolution regimes applicable to the legal entities of the group and the resolution tools available to authorities in all relevant jurisdictions. In cases where the tools specified in the Key Attributes have not been fully implemented, authorities should also consider how the preferred strategy may evolve once the full range of resolution tools is available." The NAIC believes that as the Key Attributes have not been fully implemented in many jurisdictions, these assumptions appear unrealistic. The NAIC recommends that the guidance should recognize jurisdictional differences such that resolution strategies and plans consider the actual resolution regime and legal authorities of the applicable jurisdiction(s) rather than considering theoretical strategies that are not available.

The NAIC believes that it is important to note that the Foreword of the FSB's "Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)" states the following: "[t]o promote effective and consistent implementation across jurisdictions the FSB will continue to work with its members to develop further guidance, taking into account the need for implementation to accommodate different national legal systems and market environments and sector-specific considerations (e.g., insurance, financial market infrastructures)." This recognizes that additional work is needed on the KAs, especially with regard to insurance and jurisdictional items. Although the consultative document does make some advancements in this regard, utilization of the Resolution Key Attributes as a starting point for this guidance continues to be problematic because the KAs, despite including an annex for insurance, do not account for the many ways resolution in the insurance context is different from resolution of other financial institutions, like banks (e.g., differences in liability structures and time frames), and do not adequately recognize the jurisdictional differences throughout the world (e.g., national or federal vs. state or local based regulatory structures). Therefore, for example, applying the current KAs to the way insurance companies are resolved under the U.S. state-based system poses a challenge.

The consultative document throughout does not sufficiently implement the above-stated goal of "accommodating different national legal systems." The NAIC believes that there needs to be greater recognition of the legal differences between regulatory jurisdictions in the guidance. For example, pursuant to U.S. federal law (McCarran Ferguson 15 U.S.C. §§ 1011-1015), U.S. State regulators are the primary regulators of insurance groups in the U.S. Even after enactment of the federal Dodd-Frank Act (12 U.S.C. § 5301 et seq.), the powers of U.S. State regulators with regard to U.S. systemically important

financial institutions (SIFI) and global systemically important insurers (G-SII) are not pre-empted, and this includes resolution powers. See, 12 U.S.C. § 5374 (general prohibition against preemption of U.S. state agencies); 12 U.S.C. § 5383(e) (provides U.S. state laws shall apply to insurance company resolutions).

### ***Policyholder Protection vs. Financial Stability***

In the U.S. and other countries the business of insurance is affected with the public's keen interest in making sure that insurance companies are able to pay policyholder claims whenever they come due, which is why in the U.S. the primary objective of insurance regulation is policyholder protection. This strong public policy in favor of policyholder protection in the U.S. is reflected in the priority provisions contained in laws governing insurer resolutions and the robust policyholder protection schemes available in the U.S. Although the consultative document is aimed at providing guidance for the resolution of insurance groups designated as systemically important and thus strategies for limiting systemic disruption should be implemented, we believe that the consultative document needs to better acknowledge jurisdictional differences with regard to resolution objectives. The consultative document states that "[a]uthorities should develop resolution strategies with the aim of maintaining financial stability and, to the fullest extent possible, protecting policyholders when an insurer fails."<sup>1</sup> The primacy of financial stability in this statement fails to recognize jurisdictional differences. For example, under U.S. law and as noted above, U.S. state regulators will be responsible for conducting the resolution of the U.S. insurance entities and the primacy of policyholder protection under those U.S. state laws has not been preempted by federal law. Thus, despite designation of a U.S. insurance group as a SIFI or a G-SII, the U.S. federal authorities (Federal Reserve and the FDIC) do not have the power to ignore state receivership laws or the primacy of policyholder protection in the U.S. insurance resolution regimes. While the Dodd-Frank Act does grant the Federal Reserve and FDIC additional powers, which could be used to address concerns about financial stability, those powers do not supersede policyholder protection objectives inherent in the U.S. system.

While the NAIC agrees that institution-specific resolution objectives for systemically important insurers should be identified, we note that such resolution objectives should be developed in consideration of the unique characteristics of insurance, as well as the requirements of the applicable legal regime and jurisdiction(s). Recognition of policyholder priority, the existence and role of policyholder protection schemes, separate legal entity structures, and the general principal of equal (pari passu) treatment of creditors of the same class are paramount objectives that must be protected in any resolution strategy. Accordingly, we question the legitimacy of a resolution strategy that would deprive policyholders of fundamental contractual or statutory rights, including the absolute priority that insurance receivership statutes give policyholders over the lower ranking claims of general and subordinated creditors.

### ***Home vs. Host Authorities***

Generally, throughout the consultative document, use of the terms "home" and "host" authorities is problematic because it fails to capture the structure of various jurisdictions. For example, even after the Dodd-Frank Act, the U.S. system of state-based insurance regulation provides that insurance groups may have two group-wide, and thus "home," supervisors - one federal and one state. The NAIC recommends substitution of the term "group-wide supervisor(s)" for home authorities or a definition of home authorities that captures this U.S. regulatory structure. We believe that a change in this regard will better align this document (and the Resolution KAs if amended thereafter) with International Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICP) 23 and 25.

### ***Review of Strategies & Plans***

The NAIC agrees that resolution strategies and planning should serve as a non-prescriptive guide to authorities for achieving orderly resolution in the event that recovery attempts are ineffective. However, we believe that the regular review of these strategies/plans should be conducted not only by the Crisis Management Group (CMG) through the Resolvability Assessment Process (RAP), but also during any applicable supervisory colleges conducted by group-wide supervisors with all other invited domiciliary and non-domiciliary jurisdictions. The addition of this will better align the consultative document with the descriptions of group-wide supervisors and the supervisory colleges in ICPs 23 and 25.

## **2. Are the considerations for determining "points of entry into resolution" as discussed in Section I.1 appropriate and relevant for the insurance sector?**

The consultative document identifies several factors that should be taken into account when identifying points of entry into resolution.<sup>2</sup> The NAIC recognizes that identifying points of entry into resolution is appropriate for an insurance sector resolution strategy. The considerations identified in the consultative document are all relevant. Additional considerations may also exist and be identified, depending on the unique nature and characteristics of the targeted institution and the

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<sup>1</sup> Consultative document, p. 10 (emphasis supplied).

<sup>2</sup> Consultative document, pp. 11-12.

requirements of the legal regime and relevant jurisdictions. Existence of a policyholder protection scheme (or guaranty association coverage, in the U.S.) should be added to the list. In the U.S., the statutory coverage obligations of guaranty associations are triggered by an order of liquidation and a finding of insolvency, which might not occur if resolution occurred only at the holding company level. Further, depending on the cause of the financial distress within the group, the insurance entities may be financially secure and able to satisfy all of their financial obligations (AIG's experience is a prime example). Resolution planning, and evaluation of the appropriate point of entry, must also consider whether the insurance entities may provide significant value to the enterprise and whether the appropriate point of entry is separate from the insurance operations.

**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?**

The NAIC agrees that the considerations identified in Section II of the consultative document represent the primary categories for the evaluation of a preferred resolution strategy with a few exceptions/questions noted below. The underlying analysis in Section III is also very helpful. Final analysis of a preferred resolution strategy must include analysis of the business segments and potential risks associated with a particular target institution, as well as recognition of the requirements of the legal regimes of the relevant jurisdictions for each institution. Comments on specific sections or topics are as follows:

***Determination of a Preferred Strategy***

Section II, 1, of the consultative document discusses the considerations that should be used for determining appropriate point(s) of entry into resolution. Although the introduction of Section II acknowledges that a preferred resolution strategy must take into consideration the "resolution regimes applicable to the legal entities of the group and the resolution tools available to authorities in all relevant jurisdictions," the discussion of how to choose appropriate points of entry does not include such considerations. The consultative document when providing guidance on point(s) of entry only provides for consideration of the group structure of the firm and the way its activities are organized. These considerations are important; however, the resolution authorities can only act as permitted under the applicable laws enabling resolution proceedings. Thus, the NAIC believes that consideration of the applicable legal authorities for resolution in a given jurisdiction should be added to the considerations to be reviewed when determining appropriate point(s) of entry.

***Policyholder Protection Schemes***

In the U.S., policyholder protection schemes (PPS) are an important partner in the resolution process for insurance insolvencies. Section II, 3, discusses PPS in a way that relegates consideration of the existence of such important resolution tools to an evaluation of how they can support other aspects of resolution, like the funding of a bridge institution. Given the above-stated primacy of policyholder protection under applicable U.S. laws, the NAIC believes that a more fulsome discussion of the legitimacy and importance of PPSs as (1) vehicles that promote financial stability through the protection of policyholders and (2) critical participants in the resolution planning process (see Response 8 below) should be incorporated into the consultative document. For example, the consultative document should consider the availability and effectiveness of a PPS and whether it might mitigate the fear of access to cash value becoming unavailable. Additionally the consultative document should discuss that the existence of a PPS may have an impact on the point of entry determination and run-off strategies. (This comment also applies to Section III, 5.)

The consultative document says that if an asset shortfall cannot be met by a contribution from a PPS (if available), it may be necessary to restructure policyholder liabilities to enable a portfolio transfer.<sup>3</sup> This statement appears to view PPS solely as a source of funding (as is often the case in a bank insolvency) and not as a participant in ensuring continuation of policy obligations (as is the objective under U.S. insurance laws). We therefore disagree with this aspect of the statement. But we do agree that there are circumstances in which protection of policyholders can be enhanced through restructuring of policyholder obligations to enhance a portfolio transfer. The consultation document also says that, where liabilities to policyholders need to be restructured in a solvent run-off, the policyholder protection scheme (if available) may be able to make a contribution. We do not understand why policyholder liabilities ever would need to be restructured in a solvent run-off, or why a PPS should be called upon to provide financial support in a solvent run-off. In any event, in most jurisdictions in the U.S., guaranty association protection is generally not available in the absence of a receivership order with a finding of insolvency. Further, we believe that reliance on a PPS in a solvent run-off increases moral hazard if the management of an entity believes that it might be able to rely on a PPS to assist in correcting poor management decisions.

***"Wind down Tools"***

On page 13, the "wind down tools" for an orderly run-off include terms and descriptions that appear incongruous. A "run-off on an insolvent basis" is described as a process in which a shortfall is allocated across creditors *and policyholders*, subject to

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<sup>3</sup> Consultative document, pp. 14-15.

the creditor hierarchy. A run-off in which policyholders and policy claimants absorb losses is functionally similar to liquidation. A "liquidation and winding-up" is listed as a separate "wind down" tool for an orderly run-off. It might be clearer if the guidance did not use similar and potentially confusing terms.

**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?**

The NAIC agrees that the resolution tools identified in Section II.2 are appropriate for consideration of an insurer resolution strategy. Other tools may be identified and developed based on the legal authorities of the jurisdiction, the unique characteristics of the targeted institution and the applicable policyholder protection schemes.

**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?**

The NAIC agrees that the framework proposed in the consultative document for developing effective resolution strategies and plans contains and should contain sufficient flexibility to account for the different types of business undertaken by a target institution. While maintaining flexibility in the framework, recognition of policyholder priority, the existence and role of policyholder protection schemes, separate legal entity structures, and the general principal of equal (pari passu) treatment of creditors of the same class must be protected.

**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?**

The NAIC agrees that the proposed approach contained in the consultative document is relevant and appropriate for developing effective resolution strategies. A resolution strategy should also include analysis of the regulatory authority governing and potential legal impediments to continuation of critical functions, continuity of insurance coverage, and operational continuity, based on the legal regimes and jurisdictions applicable to resolution of the targeted institution.

**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?**

Section IV, 1 - The NAIC agrees that operational plans for implementation of resolution strategies need to be developed. However, it is unclear whether this section envisions development of an operational resolution plan by applicable resolution authorities that is separate from resolution planning by the designated insurance group. This point needs to be clarified.

Also, in Section IV, 1, (i), the elements of the plan needs to be amended to recognize jurisdictional differences discussed above. Use of the term "national authorities" in this sub-paragraph is misleading and should be eliminated. We recommend the following substitute language: "different resolution authorities, communication plans, etc."

Similarly, in Section IV., 3, (i), use of the term "under the relevant national regimes" is also misleading and fails to account for jurisdictional differences in insurance regulation, including resolution as discussed above. We recommend the following substitute language: "under the relevant resolution regimes."

As discussed above, the NAIC believes that Section IV., 4, (i) and (iii) should add supervisory colleges as another vehicle, in addition to CMGs, through which establishment of the objectives and processes for cooperation can be implemented by group-wide supervisors among all home and host authorities in order to better align the consultative document with ICPs 23 and 25.

**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?**

While prior FSB guidance emphasized the need for coordination between resolution authorities and policyholder protection schemes,<sup>4</sup> the consultative document seems to view policyholder protection schemes only as a source of funds, and not as an

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<sup>4</sup> See Key Attributes 8.1 and 12.1.

important partner in the insurance resolution process.<sup>5</sup> In the U.S., regulators, receivers and the insurance guaranty system (or PPS) work together closely to protect policyholders. Our joint efforts have included contingency planning for the possible liquidation of large and complex insurers and multi-insurer groups that were experiencing financial challenges. We believe that policyholder protection schemes can and should play an important role in developing or assessing resolution strategies, and therefore they should be part of crisis management groups and other coordination efforts.

The NAIC appreciates the opportunity to submit comments. If you have any questions, please contact Rashmi Sutton (rsutton@naic.org).

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<sup>5</sup> See Consultative document, p. 24, in particular.