Excerpt from Key Attributes of Effective Resolution Regimes for Financial Institutions

II-Annex 2: Resolution of Insurers

The *Key Attributes of Effective Resolution Regimes for Financial Institutions* (the '*Key Attributes*', KAs) state that any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime consistent with the *Key Attributes*.

The systemic impact of an insurance failure can materialise in various ways, including through contagion (where policyholders or markets consider that similar problems may exist in similar products from other insurers) and financial links (for example, in the derivatives markets), and may have an impact on the broader economy through a failure to make good on promises to policyholders or to engage in new transactions that would foster economic activity.

The general assumption is that traditional insurance activities and even some non-traditional insurance activities that are no longer viable will typically be resolved through run-off and portfolio transfer procedures. It may not be possible, however, to rely on these tools in all circumstances, and particularly in those cases in which the business model is complex or there is no corresponding market for portfolio transfers. Run-off and portfolio transfer tools may not, for example, be sufficient to mitigate the systemic impact of a sudden deterioration in the viability of a larger, complex insurance group engaging in other non-traditional insurance and non-insurance activities that may involve some degree of bank-like leverage and maturity transformation. Insurance or reinsurance companies, groups and conglomerates that could be systemically significant or critical if they fail (hereinafter collectively referred to as "insurers") should therefore be subject to resolution regimes that meet the standard set out in the *Key Attributes.* Consistent with the scope of the *Key Attributes* set out in KA 1.1 the term "insurer" also includes holding companies and significant non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and branches of foreign insurers.

This Annex provides guidance on the implementation of the *Key Attributes* in relation to resolution regimes for insurers. It supplements the *Key Attributes* by indicating how particular KAs, or elements of particular KAs, should be interpreted when applied to resolution regimes for insurers. The guidance on individual KAs should be read in conjunction with the KA to which it relates.[27]

1. Objectives

1.1 A resolution regime for insurers should meet the general objectives set out in the *Key Attributes* (Preamble and KA 2.3)[28]. It should make it feasible to resolve an insurer

[27] Where components of this Annex have been deemed important for purposes of assessing compliance with the *Key Attributes*, those components are explicitly reflected in the Key Attributes Assessment Methodology.

[28] KA 2.3 provides that resolution authorities should have as their objectives both to pursue financial stability and to protect insurance policy holders. KA 2.3 does not rank the specific objectives and functions. The relative weighting and balancing of objectives may therefore vary according to the particular circumstances specific to the failing institution.

without severe systemic disruption or exposing taxpayers to loss, while protecting vital economic functions through mechanisms that make it possible for shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation. For insurers, the resolution regime should have as specific objective the protection of policyholders, beneficiaries and claimants (collectively hereafter, 'policyholders'). This however does not mean that policyholders will be fully protected under all circumstances and does not exclude the possibility that losses be absorbed by policyholders to the extent they are not covered by policyholder protection arrangements.

2. Scope of resolution regimes

2.1 Any insurer that could be systemically significant or critical if it fails and, in particular, all insurers designated as Globally Systemically Important Insurers[29] ("G-SIIs"), should be subject to a resolution regime consistent with the *Key Attributes.*

3. Resolution authority[30]

3.1 As part of its statutory objectives and functions, the authority responsible for the resolution of insurers ('resolution authority') should exercise its resolution functions in a way that meets the relevant general objectives set out in the Preamble and KA 2.3 and the specific objective of protecting policyholders (see Section 1).

3.2 To achieve its objectives, the resolution authority should coordinate with applicable schemes for the protection of insurance policyholders ('policyholder protection schemes'). The respective mandates, roles and responsibilities of the resolution authority and policyholder protection schemes should be clearly defined and coordinated.

3.3 The resolution powers may be exercised by the resolution authority directly or through a special administrator, receiver, conservator or other official subject to the same objectives as the resolution authority.

4. Resolution powers

Entry into resolution (KA 3.1)

4.1 The resolution regime should set out clear standards or suitable indicators of non-viability to guide the decision as to whether an insurer meets the conditions for entry into resolution. Such standards or indicators should allow for timely and early entry

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[29] An initial list of G-SIIs was published by the FSB on 18 July 2013: http://www.financialstabilityboard.org/publications/r_130718.pdf. The group of G-SIIs will be updated annually and published by the FSB each November, starting from November 2014.

[30] Consistent with KA 2.1 references to "resolution authority" include a reference to more than one authority where multiple authorities are responsible for exercising resolution powers under the resolution regime.

into resolution when the insurer is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so, and before it is balance-sheet insolvent. Suitable standards or indicators may include a determination by the supervisory authority, in consultation with the resolution authority (where the supervisory authority is not also the resolution authority) that, for example:

(i) The insurer is in breach of minimum capital, assets backing technical provisions, or other prudential requirements and there are not reasonable prospects of restoring compliance with these requirements;

(ii) there is a strong likelihood that policyholders or creditors will not receive payments as they fall due; and

(iii) recovery measures have failed, or there is a strong likelihood that proposed recovery measures will not be sufficient, to return the insurer to viability or cannot be implemented in a timely manner.

Choice of resolution powers

4.2 Resolution authorities should have at their disposal a broad range of resolution powers, but should in each case only use those powers that are suitable and necessary to meet the resolution objectives. The choice and application of the resolution powers provided for in KA 3 should take into account insurance specificities and, in particular, the types of business the insurer engages in and the nature of its assets and liabilities. Before the exercise of other resolution powers, the resolution authorities should consider whether the resolution objectives (see section 1) can be effectively achieved through ordinary run-off, or portfolio transfer procedures.

Control, manage and operate the insurer or bridge institution (KA 3.2 (i, ii, iii and iv))

4.3 Resolution authorities should have power, directly or indirectly, over an insurer in resolution (see section 3.3) or the bridge institution, so that the insurance business or parts of it can be carried on and the insurer or bridge institution can, where appropriate:

(i) continue to fulfil in whole or in part existing obligations under contracts of insurance;

(ii) permit the exercise of options under existing contracts of insurance, including the surrender or withdrawal of contract cash value and the payment of further premiums provided for under the existing contracts; and

(iii) buy reinsurance (or retrocession) coverage.

Restructuring of liabilities (KA 3.2 (iii))

4.4 The resolution authority should have the power to restructure, limit or write down liabilities, including insurance, reinsurance and other liabilities, and allocate losses to creditors and policyholders in a way consistent with the statutory creditor hierarchy, subject to the safeguards set out in KA 5. Powers to restructure liabilities, as

appropriate and in a manner consistent with the jurisdiction's legal framework (see Section 5), may include but are not limited to the following:

(i) reducing or terminating future (or contingent) benefits and guarantees, such as the sum assured or the annuity provided, or the guaranteed minimum sum assured or the guaranteed annuity rate, in a manner that allocates losses as appropriate to policyholders whilst maintaining continuity of insurance coverage and payments falling due;

(ii) reducing the value of contracts upon surrender, where insurance contracts have a surrender value to enable losses to be imposed as appropriate on policyholders that seek to surrender their contracts;

(iii) terminating or restructuring options provided to policyholders, for example as part of a deferred or variable annuity contract;

(iv) settling crystallised and contingent insurance obligations[31] by payment of an amount calculated as a proportion of estimated present and, if possible, future claims, to provide a more rapid and cost-effective resolution where future claims are uncertain and run-off is not feasible or there is not time to carry out a detailed actuarial valuation; and

(iv) reducing the value of, or restructuring reinsurance contracts issued by the firm, for example by imposing limits on a policy, to allow losses to be imposed on cedants, as appropriate and where this does not compromise financial stability.

4.5 The resolution authority should be able to exercise powers to restructure liabilities, subject to the safeguards set out in KA 5, without a requirement of prior individual notification to and consent from creditors, including policyholders. It should be able to exercise the powers effectively and in a way that binds unknown policyholders where:

(i) claims have not yet arisen;

(ii) claims have arisen but have not yet been notified;

(iii) claims have arisen, been notified, but not yet been estimated; or

(iv) the identity of policyholders is not known (for example because cover has been written through third parties and the claim investigation has not progressed to the point whereby all relevant parties have been identified).

Portfolio Transfer (KA 3.2(vi) and 3.7(i))

4.6 Resolution authorities should have the power to transfer contracts of insurance and reinsurance, including the power to vary or reduce the value of those contracts transferred subject to the applicable laws in each jurisdiction.

[31] This includes obligations under inwards reinsurance contracts.

4.7 Resolution authorities should have the power to transfer any reinsurance associated with the transferred policies without the consent of the reinsurer subject to adequate safeguards.

Power to suspend insurance policyholders' surrender rights

4.8 In order to achieve an effective resolution, the power of the resolution authority to suspend policyholders' rights in resolution should extend to the ability to temporarily restrict or suspend the rights of policyholders to withdraw from their insurance contracts with an insurer. The exercise of the power, its scope of application, and the duration of the stay should be appropriate to the nature of the insurance product (for example, the different nature of life and non-life insurance).

4.9 The resolution authority should, subject to adequate safeguards, have the power to stay rights of reinsurers of an insurer or of another reinsurer in resolution to terminate or not reinstate coverage relating to periods after the commencement of resolution.

5. Safeguards

Respect for hierarchy of claims in liquidation (KA 5.1)

5.1 The position of policyholders in the creditor hierarchy should be consistent with the objective of policyholder protection.

Pari passu principle (KA 5.1)

5.2 The resolution authority should have the flexibility to depart from the general principle of equal (*pari passu*) treatment of creditors of the same class and treat policyholders of different types of policies or policyholders (for example, policyholders covered by a policyholder protection scheme versus policyholders not covered by policyholder protection schemes) differently in a resolution, including in run-off or wind down proceedings, if necessary to maximise the value for creditors (including policyholders) as a whole - subject to the "no creditor worse off" safeguard (KA 5.2) - or to minimise the potential systemic impact of a firm's failure. There should be no differential treatment of policyholders holding the same type of product or policies.

6. Funding resolution

6.1 Jurisdictions should have in place privately-financed policyholder protection schemes or resolution funds that can assist in:

(i) securing continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or other insurer or use of any other resolution powers; and

(ii) compensating policyholders for their losses in the event of a wind-up or liquidation.

7. Crisis Management Groups (CMGs) and Cooperation Agreements (COAGs)

7.1 Crisis Management Groups (CMGs) and institution-specific cooperation agreements (COAGs) should be maintained or developed for G-SIIs. They can build upon existing supervisory colleges and cooperation agreements.

8. Resolvability assessments

8.1 Any insurer that could be systemically significant or critical upon failure, and at a minimum all G-SIIs, should be subject to regular resolvability assessments that are conducted in accordance with KA 10 and I-Annex 3.

8.2 In undertaking a resolvability assessment to evaluate the feasibility and credibility of implementing the resolution strategy and operational resolution plan developed for the insurer, resolution authorities, in coordination with other relevant authorities, should assess in particular whether the chosen resolution strategy ensures the continuity of critical functions and can be implemented without severe systemic disruption and without exposing taxpayers to loss.

8.3 The assessment of the feasibility of the resolution strategy should cover as appropriate:

(i) the likely availability of a transferee or purchaser for any business activities of the insurer in resolution, taking into consideration the ability to use a bridge institution to operate the business on a temporary basis;

(ii) the time needed to evaluate policyholder liabilities and the assets supporting, backing or to be transferred as consideration for assuming the liabilities, and for a potential transferee to carry out due diligence;

(iii) the capacity of the policyholder protection scheme or resolution funds to fund a transfer where there are insufficient assets to resolve all insurance liabilities in a timely manner;

(iv) where the resolution strategy includes a solvent run-off, back-up plans to address the risk that the insurer will not remain solvent for the whole duration of the run-off;

(v) where the resolution strategy includes a run-off (whether solvent or insolvent), the feasibility of maintaining a risk management programme (such as a hedging strategy) which ensures that the risks to policyholders appropriately reflect the features of the policies they hold (including any options and guarantees).

(vi) the quality of management information systems and the capacity of the insurer to deliver detailed, accurate and timely information on the relevant data and information needed for the purposes of orderly resolution (see paragraph 10.1);

(vii) availability of human resources and key personnel (for example, staff may be employed by a different group entity);

(viiii) the extent to which a sale, transfer, run-off or orderly wind down of different business activities can be accomplished (for example, whether the activities are sufficiently separable to be sold or transferred);

(ix) the extent to which corporate capital structures would permit a bail-in within resolution in accordance with KAs 3.5 and 3.6;

(x) the legal, operational and financial separateness of traditional insurance business from non-traditional insurance and non-insurance business;

(xi) the extent to which service agreements or outsourcing agreements that are necessary to ensure continuity of essential services and functions (for example, claims servicing), including services provided by entities in another jurisdiction, can be maintained in resolution;

(xii) the extent to which any interconnections or interdependencies between group entities through intra-group transactions (for example, reinsurance transactions, loans or letters of credit, collateral upgrades or other liquidity support provided to banking entities, guarantees or letters of support, cost sharing or profit and loss-sharing agreements among affiliates) and any interconnections or interdependencies with third parties affect the implementation of the resolution strategy;

(xiii) how contractual termination events (including cross-default) in financial contracts of the insurer are defined (for example, whether rating down-grades, restructuring or (solvent or insolvent) run-off if occurring in a single entity within the insurer (insurance group), could trigger early termination of contracts of other entities in the group; and

(xvi) the ability to fund the continued operations of critical functions and services, for example, ability to meet potentially increased demands to post collateral.

8.4 When assessing the credibility and overall impact of implementing the resolution strategy, consideration should be given to its effects on third parties and on financial stability in affected jurisdictions, including whether the resolution of the insurer would cause:

(i) a material adverse impact on economic activity as a result of any disruption to continuity of insurance cover and payment, which is likely to be greatest when insurance is a pre-requisite to day-to-day economic activity (for example, employers' liability, trade credit and transport liability insurance), where a disruption in insurance claims and benefit payments is likely to cause significant and widespread financial hardship to households and businesses, or where the insurer has a significant share of the market;

(ii) a lack of confidence in other insurers triggering a policyholder run, particularly where the insurers provide insurance that resembles on-demand savings products;

(iii) an adverse impact on the resolvability of insurance or other financial operations undertaken elsewhere in the group;

(iv) large investment losses for other financial institutions that could affect the insurer's capital resources;

(v) the termination of securities lending and reverse repo operations that could affect funding and liquidity for other parts of the financial system; and

(vi) an amplification of financial market disruption owing to the termination of financial guarantees or credit default swaps.

9. Recovery and resolution planning

9.1 All insurers that could be systemically significant or critical upon failure, and at a minimum all G-SIIs, should be subject to a requirement for an ongoing process of recovery and resolution planning.

9.2 Recovery and resolution plans (RRPs) need to be tailored to the specific risks and systemic implications that each insurer may be exposed to or create and take into account factors such as the types of business the insurer engages in, its derivatives transactions, intercompany guarantees, inter-affiliate support arrangements, risk pooling, shared services, risk management model and the nature of its assets and liabilities.

9.3 A key component of RRPs is a strategic analysis that identifies the insurer's critical functions and sets out the key steps to maintaining them in both recovery and resolution scenarios. Elements of such analysis should include identification of essential and systemically important functions, mapped to the legal entities in which they are conducted.

Recovery plans

9.4 Recovery plans should be developed on the basis of severe stress scenarios that combine adverse systemic and idiosyncratic conditions. They need to take into account insurance specificities such as the longer pay-out duration and the liquidity profile of insurers.

9.5 The insurer's supervisory authority should review the insurer's recovery plan and cooperate with the policyholder protection scheme and relevant resolution authorities, as appropriate.

9.6 In the case of G-SIIs, the review of the recovery plan should be carried out within the insurer's CMG.

9.7 Insurers should identify possible recovery measures and the necessary steps and time needed to implement such measures and assess the associated risks of implementation. The range of possible recovery measures could include:

(i) actions to strengthen the capital situation, for example, recapitalisations after extraordinary losses, capital conservation measures such as suspension of dividends and payments of variable remuneration;

(ii) triggering of contingent capital instruments;

(iii) possible sales of subsidiaries, portfolios of insurance contracts, or spin-off of business units;

(iv) changes to the reinsurance programme;

(v) changes to the investment strategy and hedging programme;

(vi) changes to business mix, sales volumes and product designs, including options to close books of business to new sales or business;

(vii) changes to underwriting and claims handling practices; and

(viii) modifications to contract terms and conditions, the level of charges, fees and surrender payments, the amount and timing of any discretionary benefits and the operation of discretionary incentives to renew contracts (such as 'no-claims discounts' or contract renewals without new underwriting).

9.8 An insurer in solvent run-off should be required to have a scheme of operations plan that sets out how all liabilities to policyholders will be met in full as they fall due and should include, for example, details on how expenses can be reduced as business volumes fall.

Resolution strategies and plans

9.9 In the case of G-SIIs, the resolution strategies and plans should be developed within the insurer's CMG.

9.10 Resolution plans for insurers should contain the essential elements set out in I-Annex 4, as appropriate to insurers in general and to the type of insurer, and include in particular the following:

(i) identification of policyholders that are protected by a policyholder protection scheme and policyholders that are not eligible for benefits from such schemes;

(ii) the actuarial assumptions used for calculating insurance liabilities and an independent actuarial valuation of the technical provisions (policyholder liabilities);

(iii) review of asset quality and concentration issues;

(iv) preparation of insurance portfolio transfers to the best extent possible, including a determination of the acceptability of assets to be transferred to any insurer assuming liabilities in a portfolio transfer;

(v) sources of funding;

(vi) provision for continuity or an orderly winding down of any derivatives portfolio;

(vii) details on a transfer of reinsurance, if any, and impact on coverage;

(viii) operational and practical arrangements for ensuring continuity of coverage and payment under insurance policies, and, where appropriate, a restructuring or termination of insurance policies;

(ix) identification of major counterparties and their interconnectedness with the insurer, and the impact that the failure of a major counterparty would likely have on the insurer;

(x) a communications and coordination strategy with insurance policy holder protection schemes and other authorities with a role in the resolution of an insurer, and

(xi) participation in financial market infrastructures.

10. Access to information and information sharing

10.1 Insurers that could be systemically significant or critical upon failure, including all G-SIIs, should be required to maintain information systems and controls that can promptly produce, both in business as usual and as the firm approaches resolution, the relevant data and information needed to establish and maintain a resolution strategy and operational resolution plan and to implement resolution measures in a timely manner. The following information, in particular, should be readily available:

(i) the number and type of insurance policies, the benefits due to each policyholder and the reinsurance in place;

(ii) details of eligibility for protection under policyholder protection schemes and the scope of protection for eligible policyholders;

(iii) insurance and financial products that could be prone to runs;

(iv) information on assets, especially assets backing the insurance liabilities, the fungibility of any surplus assets between jurisdictions in stressed conditions, and custodians of assets; and

(v) information about service agreements or outsourcing agreements that are necessary to ensure continuity of essential services and functions of the insurer.