



Institute  
and Faculty  
of Actuaries

# Cross-border recognition of resolution action

Response to the Financial Stability Board

1 December 2014

## **About the Institute and Faculty of Actuaries**

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



Secretariat to the Financial Stability Board  
Bank for International Settlements  
Centralbahnplatz 2  
CH-4002 Basel  
Switzerland

1 December 2014

Dear Sirs

### IFoA response to FSB consultation on cross-border recognition of resolution action

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FSB's consultation on cross-border recognition of resolution action. This response has been prepared by the IFoA's Recovery and Resolution Working Party, whose members have experience of resolution in the insurance industry.

#### General comments

2. The FSB's consultation document on cross-border recognition of resolution action is part of its efforts to end the 'too big to fail' phenomenon, a form of moral hazard in which major financial institutions are encouraged to take excessive risks in the knowledge that the supervisory authorities will feel compelled to bail them out because of their size and importance.
3. The IFoA strongly supports these efforts. In order to remove the element of moral hazard, it must be clear to institutions that, in the case of failure, the authorities will be able to implement the resolution process, including for cross-border institutions. In response to the FSB's consultation on the Assessment Methodology for the Key Attributes of Effective Resolution Regimes for Financial Institutions we supported "fair treatment across different jurisdictions, the avoidance of discrimination, the support of information sharing, and allowing either the home authority to take action over overseas branches or a host country to take action".<sup>1</sup> We reinforce that earlier position in this response.

#### Question 1: Are the elements of cross-border recognition frameworks identified in the report appropriate? What additional elements, if any, should jurisdictions consider including in their legal frameworks?

4. The document lists seven elements that jurisdictions should consider including in legal frameworks. We comment on each below:
  - i. A domestic authority can legally give effect to foreign resolution measures. We endorse this approach, particularly with the proposed conditions that focus on treating domestic creditors fairly and protecting local financial stability.

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<sup>1</sup> <http://www.actuaries.org.uk/research-and-resources/documents/fsb-assessment-methodology-key-attributes-effective-resolution-regi>

- ii. Clarity about whether foreign resolution measures will apply automatically or whether the local authority has any discretion in this. The document suggests that sometimes foreign actions will apply automatically providing certain domestic conditions are met. In other cases, recognition will be discretionary, in accordance with domestic law. We would suggest that the transparency of the process is more important than the legal mechanism because the route resolution may take will be highly dependent on the circumstances – both at a macro and a company level.
  - iii. Identifying the grounds for any recognition procedure or support mechanism. The IFoA agrees that a domestic authority should be obliged to recognise foreign resolution actions, with certain exceptions, and supports the valid reasons stated for the domestic authority to decline a foreign request – if it harms local financial stability, treats domestic creditors unfairly or leads to loss for the authorities or taxpayers. However we believe that it would be helpful to frame the exceptions more broadly, in order to take account of a range of circumstances and types of policy. For example, there could be a case for handling with-profits products differently, depending on how generously they had been treated in the past. As an assessment of fairness is a relative concept, it is likely to be challenging without looking across the Group. In respect of with profits life business, this is an area where actuaries have expertise and we would welcome the opportunity to discuss this further with the FSB.
  - iv. Equitable treatment of creditors. The IFoA supports the view that there should be no discrimination between creditors based on their nationality, or the location of their claim. This should help to ensure that all creditors of an entity are treated according to the same rules or standards, bearing in mind that (a) a variety of measures may be used to compare claims, such as the claim size, continuity of cover, future premiums or the fair value of guarantees; and (b) non-discrimination by nationality or location will still leave scope for creditors to be ranked by priority.
  - v. The need for speed in resolution. We would highlight important differences between insurers and banks in this respect. Resolution for an insurer does not necessarily mean paying out to policyholders, so expediency is also important in terms of communication and agreeing how future cover is going to be provided. We would also note that, while speed may be desirable in the absence of other considerations, a quick resolution overall is not always appropriate. For example, whilst operational issues may require swift short-term action, more complex processes may apply to resolving other financial and legal issues.
  - vi. Those who recognise or support foreign resolution actions should have legal protection; it should not be possible to override their decisions unless they were not made in good faith. We agree that there should be legal protection for authorities and officials in these circumstances. We would suggest that in some jurisdictions the grounds for challenging such decisions could also include incompetence.
  - vii. Authorities should encourage contractual approaches by firms, as reinforcement for the statutory approach or as an interim measure. The IFoA supports the interim use of a ‘contractual approach’.
5. We suggest that it is too soon to identify additional elements to be included in legal frameworks. More experience of applying existing frameworks to cross-border resolutions is likely to shed more light on this.

**Question 2: Do you agree that foreign resolution actions can be given effect in different ways, either through recognition procedures or by way of supportive measures taken by domestic authority under its domestic resolution regime? Do you agree with the report's analysis of these approaches?**

6. We agree that both of these approaches to resolving foreign entities are valid, and both can ensure that creditors are treated equitably. The FSB may wish to consider possible circumstances that fall between the two approaches, for example where domestic law rules out recognition and, as the domestic resolution process has yet to be developed, the domestic authority cannot take supportive measures either.

**Question 3: Do you agree that achieving cross-border enforceability of (i) temporary restrictions or stays on early termination rights in financial contracts and (ii) 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity is a critical prerequisite for the effective implementation of resolution strategies for global systemically important financial institutions (G-SIFIs)? Is the effective cross-border implementation of any other resolution actions sufficiently relevant for the resolvability of firms that the FSB should specifically consider ways of achieving their cross-border enforceability?**

7. We agree that it is important to find contractual solutions to achieve resolution for these two cases, given that it will take time to implement statutory frameworks. In doing so, it will be important to achieve an approach that can be applied consistently to both the practical realities of resolution and to the requirements of Solvency II. For example, Solvency II quantitative analysis will make assumptions about fungibility of capital in extreme scenarios and, whilst this will typically be a less severe stress than that need to trigger resolution, any barriers to resolution should also be considered for Solvency II purposes.

**Question 4: Do you agree that contractual approaches can both fill the gap where no statutory recognition framework is in place and reinforce the legal certainty and predictability of recognition under the statutory frameworks once adopted?**

8. We agree that contractual provisions should improve the chances of achieving resolution effectively and in good time, whether or not a statutory framework is in place. However, the consultation document itself (p11) recognises that the contractual approach alone might provide less legal certainty than a statutory framework. It also acknowledges that "the enforceability of such contractual recognition provisions has yet to be tested in the courts". We would welcome more clarity on the extent to which contractual arrangements can take priority over insolvency law.
9. We also note that some firms may be comfortable with contractual arrangements for small or well-defined issues, but many may choose to avoid contractual constraints on how they respond to greater challenges, such as, a major economic crisis.

**Question 5: Are the key principles for recognition clauses in debt instruments set out in the report appropriate? What other principles or provisions do you consider necessary to support the exercise of 'bail-in' powers in a cross-border context?**

10. Where the resolution authority exercises 'bail in' powers to write off or convert debt issued by the failing institution, the document lists five principles to ensure through a contract that this can be enforced with a cross-border debt holder.
11. The IFoA agrees with the proposed principles for recognition clauses. We note that this issue is likely to be less important for insurers than for banks, since insurers issue less debt.

12. Should you wish to discuss any of the points raised please contact Matthew Levine, Policy Manager ([matthew.levine@actuaries.org.uk](mailto:matthew.levine@actuaries.org.uk) / 0207 632 1489).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Nick Dexter', with a horizontal line extending to the right.

Nick Dexter  
**Chair, Recovery and Resolution Working Party**  
**Institute and Faculty of Actuaries**