



Institute
and Faculty
of Actuaries

Consultation Paper: Key Attributes of Effective Resolution Regimes in the Insurance Sector

IFoA response to Financial Stability Board

28 February 2018

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.



Key Attributes Consultation
Financial Stability Board
Centralbahnplatz 2
CH-4002
Basel
Switzerland

28 February 2018

Dear Sirs,

IFoA response to Consultation Paper: Key Attributes of Effective Resolution Regimes in the Insurance Sector

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the FSB's Consultation Paper (CP) on the Key Attributes of Effective Resolution Regimes in the insurance sector. The IFoA members involved in drafting this response have between them many years of experience in working with firms who have either prepared resolution plans or been considering similar issues in the context of stress and scenario planning exercises, including reverse stress testing.

Question 1: Is the draft methodology adequately tailored to the specific features of resolution regimes that are needed to deal with insurers or insurance groups that could be systemically significant or critical if they fail? Are there any elements that should be covered or elaborated in more detail in the methodology?

2. We note the condition in section III that there should be 'no potential obstacles to effective implementation' for a jurisdiction to be compliant with a Key Attribute (KA). This is unlikely to be possible in practice and we suggest that the test should relate to 'no reasonably foreseeable material obstacles'.
3. Explanatory Note (EN) 3a defines non-viability relative to viability, but does not actually define viability in its own right. The issue here is that generally an insurer has to meet 'normal' capital requirements; with regulatory forbearance however, a firm may be able to enter run-off without being fully capitalised, with full resolution then only being necessary subsequently if there are signs of further deterioration in experience.

Question 2: Should the draft methodology provide any specific guidance on how to conduct an assessment for financial conglomerates that combine insurance business with banking and/or other non-insurance financial business? If so, what guidance should be provided?

4. It is likely that there will be different resolution regimes for banks and insurers and there are also likely to be various interconnected arrangements between any banks and insurers in the same group. Consequently, it is important that the resolution plan for such a conglomerate addresses these issues. Whilst one jurisdiction could address these issues if the

conglomerate were solely active in that jurisdiction, it is possible that several jurisdictions could be involved. In these cases some overarching guidance would probably be helpful covering areas such as the need to establish an approach to resolving intra-group arrangements, and a Crisis Management Group (CMG) which involves the resolution authorities for both the insurance and banking entities.

Question 4: Do the preconditions set out in Section V cover the relevant elements that are necessary for resolution regimes for insurers to operate effectively?

5. One of the difficult areas which is acknowledged by Precondition E is the fact that conventional corporate bankruptcy or insolvency typically does not work well for insurers. This is due to the more complex hierarchy of creditors in an insurance context and the interaction between the different parties; including potentially an insolvency practitioner, regulators, resolution authority and Policyholder Protection Scheme (PPS). Therefore, in our view a precondition would be that the various aspects of legislation work coherently. Furthermore, in some jurisdictions the transfers of portfolios of insurance policies from one insurer to another can involve a lengthy court process, whereas a resolution regime ideally requires a much quicker process, and hence new legislation is likely to be required to enable this.

Question 5: Do the ECs and ENs proposed in Section VI focus on relevant features of resolution regimes for insurers that need to be in place to comply with the Key Attributes, taking due account of the differences between the resolution of insurers and the resolution of other types of financial institutions? Are any elements inappropriate? What, if any, additional features should be covered in ECs and ENs?

6. Our view is that Section VI covers the *key* features that it needs to. However, one area not currently covered is transition. It is likely there will be multiple areas such as third party contracts which will need amending to be fully compliant with the requirements, and it may be easier to renew these with revised terms as they expire naturally. In addition developing suitable legislation which might need to over-ride normal company law in this area may take a number of years and it may be sensible to implement some aspects of the requirements before the new legislation is fully enacted.

Question 6: Do the ECs and ENs proposed in Section VI take due account of the different types of insurance business and insurance products (for example, life insurance, non-life insurance and reinsurance)? What, if any, additional features should be covered in ECs and ENs?

7. We believe there could be a fuller consideration of reinsurance. In particular, in the EU (Solvency II Articles 268 1(g) and 275), inwards reinsurance ranks below directly written business in the credit hierarchy. This may unduly affect the ceding insurer in the event of the resolution of a reinsurer which also (or primarily) writes direct insurance business.
8. We also note that EN 4a implies that assets that are linked to insurance contracts receive special treatment. However, in the UK, absent a change in legislation, linked funds would not survive resolution and such assets would be co-mingled with all the other assets. The alternative would imply introducing a hierarchy of direct policyholders.
9. We agree with the safeguards set out in KA 5, but believe there should be a more explicit recognition for an insurer in resolution. It is likely that a full assessment of the value of assets and liabilities will be challenging, and there will likely be a range of results. This is likely to lead to a delay in claims being paid out in full for some time from the point of going into

resolution. The resolution authority will need to balance the need to pay out as much as is possible for claims as they fall due, with the security for policyholders whose claims are still to be paid. It is likely any PPS will want to play an active part in this process.

10. In KA 6, the intention is that any funds needed to bail-out an insurer would ultimately come from 'the financial system more widely'. Whilst this would be feasible for the idiosyncratic failure of a small to medium insurer, it is likely that the circumstances which lead to the failure of a larger insurer would be such that other insurers would be affected by the same or similar events. In such a market-wide scenario any levy on the industry survivors could well render them non-viable as well, making such a levy unfeasible.

Question 7: Do the ECs and ENs for KA 4 identify the features of the resolution regimes relating to set-off, netting, collateralisation and segregation that are relevant for insurance resolution?

11. Although we agree that the features set out in KA 4 are sensible, we note there may need to be transitional arrangements as existing contracts may not exhibit these features. For example, current reinsurance treaties may include the right to terminate the contract in certain circumstances, which may apply if an insurer were to enter resolution.
12. We also note that, given the likelihood that in a recovery scenario there would be uncertainty over the value of assets and/or liabilities, there may need to be a stay as set out in KA 4 point 4.3(i). However, we believe the two-business-day limit should be extended as this appears to be unnecessarily short.
13. We also refer to our response to Question 6 above on EN 4a, in respect of assets that are linked to insurance contracts.

Question 8: Does the draft methodology (in particular EC 4.1 and EN 4 (a)) address the treatment in resolution of assets linked to insurance contracts (including segregation of such assets) in an appropriate and comprehensive manner?

14. Again, we refer to our response to Question 6 above.

Question 9: Are there any other issues that the FSB should address in its further work, outside of or in addition to the work on the methodology, in order to assist national authorities in their reforms of resolution regimes for insurers and resolution planning for systemically important insurers?

15. We note that in several places the EC wording duplicates that of the KAs, and such duplication could be reduced to simplify the document.

Should you wish to discuss any of the points raised in further detail please contact Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk / 0207 632 2146) in the first instance.

Yours sincerely



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