National Organization of Life & Health Insurance Guaranty Associations

NCIGF
National Conference of Insurance Guaranty Funds

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JOINT SUBMISSION OF NOLHGA AND NCIGF REGARDING FSB RECOVERY AND RESOLUTION PLANNING FOR SYSTEMICALLY IMPORTANT INSURERS: GUIDANCE ON IDENTIFICATION OF CRITICAL FUNCTIONS AND SHARED SERVICES

The National Organization of Life and Health Insurance Guaranty Associations and the National Conference of Insurance Guaranty Funds respectfully submit their joint comments regarding the Financial Stability Board's (FSB) consultative document titled, "Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Shared Services."

NOLHGA and NCIGF are an integral part of the policyholder protection scheme ("PPS") in the United States, coordinating the provision of guaranty association benefits to U.S. insurance consumers whose insurance carriers become insolvent. NOLHGA's members are principally concerned with protecting consumers of failed life, annuity and health insurers, and NCIGF's members are principally concerned with protecting consumers of failed property and casualty insurers.

NOLHGA and NCIGF support the FSB's emphasis on advance planning as a means of reducing the potential for failure and promoting resolvability of global systemically important insurers. We appreciate the opportunity to provide responses to the questions posed by the consultative document.

As a threshold matter, we are curious about the consultative document's treatment of traditional insurance company functions, as it seemingly departs from previous pronouncements by international authorities. As recognized by the International Association of Insurance Supervisors (IAIS) and the FSB,

> [N]either long experience of insurance markets nor information arising from the global financial crisis provides *any* evidence of traditional insurance either generating or amplifying systemic risk within the financial system or in the real economy. The potential for systemic importance is only considered to arise in any non-traditional or non-insurance activities.[1]

[1] International Association of Insurance Supervisors, *Global Systemically Important Insurers: Initial Assessment Methodology* (July 18, 2013), at p. 9 (emphasis supplied). The FSB has endorsed that methodology. Financial Stability Board, *Global Systemically Important Insurers (GSIIs) and the Policy Measures That Will Apply to Them* (July 18, 2013), at p. 1.

We hope that, by identifying a number of traditional insurance products and functions that could be considered critical under certain circumstances, the FSB is not rejecting the evidence cited by or the conclusions reached by the IAIS and previously endorsed by the FSB.

Against that backdrop, here are our responses to certain questions raised by the consultative document. Most of our responses focus on those aspects of the document that implicate PPSs.

Question 1: Are the definitions of "critical functions" and "critical shared services" appropriate for the insurance sector?

> With respect to the "critical function" definition (which is set forth in the taxonomy section of the consultative paper), we question whether the disruption of traditional insurance payments would ever have systemic impact or result in contagion. That being said, insurance regulation/supervision exists to ensure that insurers fulfill the contractual promises they make to consumers. PPSs have the same purpose when an insurer fails. In the United States, the fundamental responsibility of a PPS is to assure the provision of insurance protection to consumers[2], up to a statutorily established level of guaranteed protection, once the duties of the PPS have been "triggered" by a judicial determination that an insurer is insolvent and should be liquidated. (In most cases, policyholders with claims exceeding a PPS' statutory protection level also receive substantial recoveries from assets remaining in the estate of the failed insurer.) In short, the existence of a PPS mitigates, and in many cases eliminates, the financial impact of an insurer's failure on policyholders and others.

Question 3: Is the methodology for identifying critical functions laid out in the paper appropriate for the insurance sector? If not, what aspects are missing or need to be changed?

> We have two comments with respect to the methodology for identifying critical functions (which is set forth in the framework for critical functions section of the consultative paper).
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> First, we note that the presence of a PPS may eliminate, or significantly mitigate, the concerns about substitutability expressed in the consultative document. In the U.S., once a PPS is triggered by a judicial determination that an insurer is insolvent and should be liquidated, the association has two principal sets of duties to consumers. First, the PPS must pay, within statutory coverage limits, any claims that are or become ripe for payment, including such periodic payments as are designated by the policy terms such as bi-weekly indemnity payments for injured workers as they become due. Second, as to contracts that the failed insurer had no right to cancel prospectively (e.g., annuities, most non-term life insurance contracts, and some types of health insurance contracts), the PPS must guaranty, assume, or reinsure the continuing insurance coverage. In other words, the association must make sure that the coverage continues, as long as the consumer pays any required premium.

[2] This insurance protection includes the paying of claims, continuing certain coverage and refunding unearned premium.

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Second, we hope that the FSB will consider providing additional guidance regarding how governmental authorities should determine whether the sudden failure of a particular insurance function could (a) give rise to contagion or (b) undermine the general confidence of market participants. We believe that those determinations should be made with the same analytical, evidence-based approach as determinations of whether a sudden failure of an insurance function would have a material impact on third parties.

Question 4: Do the six broad categories of activities outlined below cover all relevant and potentially critical functions? What additional categories, if any, should be added?

iii. Insurance payments that are vital to an individuals' financial security

Section 3.3(b) of the consultative document states that "payments supported by unfunded policyholder protection schemes may be more likely to spread industry contagion." We disagree with that conclusion, at least as it relates to the U.S. system.

Under the U.S. system, PPS assessments are highly unlikely to cause severe financial strain on other insurers, for several reasons. First, a significant share of PPS funding comes from assets remaining in an insolvent insurer and future premiums payable on policies that are continued, and not from assessments on other companies. Second, to the extent assessments are required, they are "capped" in most states at a level of 2% of applicable premium in any year. Third, most states have provisions permitting cost recovery of part or all of the assessments as offsets or reductions of taxes otherwise payable in the state. Fourth, the liquidity demands on a PPS generally are much lower than those of, e.g., a bank deposit scheme, because obligations of the PPS (unlike a bank's liabilities in respect of demand deposit accounts) are not due and payable at the time of an insurer's failure, thus permitting the PPS to fund its obligations over a period of years. Finally, a PPS has the authority to abate assessments owed by a member company if the payment of an assessment would pose a solvency risk to that member company. [3]

[3] See, generally, IAIS, *Issues Paper on Policyholder Protection Schemes* (October 2013), at p. 13, which reports that in the United States,

> PPSs draw from several sources of funding to pay claims, including (1) the assets remaining in the insurance company (which are usually substantial and provide the primary source of funding payments to consumers in most insolvencies), and (2) ex-post assessments collected from member insurance companies. This funding mechanism was designed to use as much of the failed company's remaining cash as possible. The PPSs levy assessments on viable insurance carriers only to the extent that a shortfall remains after the available estate assets have been exhausted. In that case, the PPS assesses the healthy insurers who do business in that state, up to state-specified coverage limits (e.g., $300,000 for life insurance benefits) and annual limits (which are typically 2% of net direct written premium received in the year prior to the assessment for property and casualty insurance companies, and 2% of average annual premiums received during the three years prior to the assessment for life and health insurance companies).

Question 6: Is the framework flexible enough to cover the different types of business undertaken by G-SIIs? Are the non-prescriptive lists of examples of functions that could be critical helpful?

> As we noted at the outset, by identifying traditional insurance products and functions that could be considered critical under certain circumstances, the consultative document seems to depart from prior pronouncements made by the IAIS. We are concerned that the document could have significant (and presumably unintended) consequences not only for resolution planning, but also for the identification of systemically important insurers.

Thank you for the opportunity to comment. If you have further questions, please do not hesitate to contact us as set forth below.

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