

PCI Comments

FSB Request for Comment on Consultative Document Developing Effective Resolution Strategies and Plans for Systemically Important Insurers

January 4, 2016

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to offer comments on the Financial Stability Board's (FSB) November 3, 2015 consultative document on Developing Effective Resolution Strategies and Plans for Systemically Important Insurers ("Consultative Document"). PCI is composed of nearly 1,000 member companies, representing the broadest cross section of insurers of any U.S. national trade association. PCI members write more than \$195 billion in annual premium, 35 percent of the property casualty insurance written in the U.S. Member companies write 42 percent of the U.S. automobile insurance market, 28 percent of the homeowners market, 33 percent of the commercial property and liability market and 35 percent of the private workers compensation market.

While PCI describes below several key concerns we have with the Consultative Document, we believe that, on the whole, it suggests a generally useful approach to resolutions which incorporates many key elements of the successful U.S. resolution system.

Scope and General Issues

PCI has commented on two previous, related FSB documents: (1) the Key Attributes of Insurance Resolution Regimes (2013); and (2) a consultative document on Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services. In both of those comments, PCI expressed strong concern that the FSB provides inconsistent and sometimes conflicting descriptions of the scope of the documents. While these documents often seem aimed at insurers that have been designated as globally systemically important insurers (G-SIIs), they all also at various points apply to firms that could be "critical if they fail." The FSB's descriptions of critical functions are quite similar to the characteristics of systemically important firms, but in suggesting that firms other than those designated as systemically important may have critical functions, PCI has expressed concern that the FSB may be inappropriately expanding the scope of its resolution planning documents beyond systemically important firms.

PCI finds that the Consultative Document continues to suffer from an unclear, but potentially overbroad scope. While the title of the document refers to resolution strategies and plans for "systemically important insurers," the text notes that it "may also be relevant for insurers identified by any national authority as systemically important if any." The footnote then invites readers to "refer to discussion of economic importance of insurance functions in Section 1 and impact on financial stability criticality of an insurer's functions in Section iii(2)." We have argued in comments on previous FSB documents that the critical functions the FSB has previously identified in the insurance industry are not, in fact, indicative of systemic risk in the insurance industry and should not give rise to any departure from existing resolution rules in the U.S.

If the FSB is to continue to refer to “critical functions,” we would respectfully suggest that definition be amended as follows to strengthen the connection between critical functions and systemic risk.

a. Definition of critical function

For purposes of the Guidance, a critical function has both of the following elements:

- (i) It is provided by an insurer to third parties not affiliated to the firm; and*
- (ii) The sudden failure to provide that function would be likely to have a material impact on the financial system and the real economy, ~~give rise to contagion or undermine the general confidence of market participants~~ (by giving rise to systemic disruption of the financial system and the real economy or giving rise to systemic contagion).*

Services that do not have a significant impact on economic and financial stability or that can be substituted with a minimum of time and cost should not be considered critical.

PCI is concerned that the current wording of (ii) above implies that functions that cause “systemic disruption” or an undermining of “general confidence of market participants” is separate and different from functions that have a material impact on the financial system and the real economy. In fact, disruption, lack of confidence, and contagion are just ways in which such functions might arguably have a material impact on the financial system and the real economy. The suggested amendment above is intended as a helpful clarification.

As we have in the past, however, PCI strongly commends the FSB for including in the definition a statement that substitutability renders functions non-critical. We particularly agree with the FSB’s statement on page 16 that there is “sufficient substitutability . . . for the majority of P&C insurance products.”

It is also critically important to recognize the unique characteristics of property casualty insurance and property casualty insurance regulation, including resolution and policyholder protection systems. While the issue is summarily addressed on page 16, we think the paper should be even stronger and clearer in its instructions to readers to take these characteristics fully into account in applying the paper. In addition, we feel there is too little recognition of the importance of the legal framework applicable to the regulator/supervisor and the central role for neutral third party courts to defend the legitimate rights of all interested parties.

Primary Objectives of Resolution Schemes

The U.S. resolution system has as its primary objective the protection of policyholders. Indeed, that is the primary objective of insurance regulation generally in the U.S. The interests of general and subordinated creditors are secondary to those of policyholders. We do recognize that the Consultative Document is primarily concerned with the resolution of G-SIIs and that such resolutions necessarily require that resolution authorities consider potential impacts on financial stability that would not be considerations in ordinary resolutions. Nevertheless, PCI believes that goal of policyholder protection should not be compromised. 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.” This wording strikes us as giving top priority to financial stability while assigning a lower priority to policyholder protection, *i.e.*, something that would also be

nice to achieve but only where it does not compromise financial stability. At a minimum, we urge the FSB to revise this language to read “[a]uthorities should develop resolution strategies with the aim of protecting policyholders when an insurer fails and protecting financial stability.” This at least gives as equal status to both goals.

Points of Entry

PCI appreciates the FSB’s acknowledgement that resolution at the operating company level may be appropriate. We would suggest that an operating company approach will likely be the most appropriate for insurance groups with many or all of the characteristics set out in Section II.1.b. It is particularly important to recognize that, in the U.S., guaranty fund protection is triggered by a finding of insolvency of an operating insurance company and thus might not be available in resolutions conducted at the holding or parent company level.

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Finally, PCI commends to the FSB the joint comment letter submitted by the National Organization of Life and Health Insurance Guaranty Associations (NOHLGA) and the National Conference of Insurance Guaranty Funds (NCIGF). The views expressed by NCIGF and NOHLGA are generally consistent with PCI’s, particularly in highlighting the important role that policyholder protection schemes can and should play in partnering with other resolution authorities to develop resolution strategies. They bring experience and expertise to the process that is invaluable, and we join in encouraging the FSB to include in the Consultative Document an affirmative statement that policyholder protection schemes should be part of crisis management groups and other coordination efforts. NCIGF and NOHLGA have also emphasized the importance of maintaining policyholder protection as a top priority. They have suggested several helpful drafting changes that seek to address our shared concerns with respect to these issues.