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PCI Comments

FSB Request for Comment on Key Attributes of Insurance Resolution Regimes

October 15, 2013

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to offer comments on the Financial Stability Board's (FSB) consultative document on *Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions*. Our comments relate primarily to Part II and Appendix II of the document, which address the resolution of insurers. PCI is composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than $195 billion in annual premium, 39 percent of the nation's property casualty insurance. Member companies write 46 percent of the U.S. automobile insurance market, 32 percent of the homeowners market, 37 percent of the commercial property and liability market, and 41 percent of the private workers compensation market.

PCI's overarching comment on the consultative document is that it is inappropriately broad in scope. As drafted the document would apply to any insurers "that could be systemically significant *or critical if they fail*" (emphasis added). The document provides little or no definition of the phrase "critical if they fail." Insurers, and in particular, property casualty insurers, are generally not systemically risky, much less "critical if they fail." We are concerned that the use of this undefined phrase could effectively broaden the scope of the document to apply to *any* insurer, and that even a more limited definition of the phrase would inevitably still be inappropriately broad.

PCI recommends, at a minimum, that the FSB amend the document so that it clearly applies *only* to companies that have been designated as systemically important and does not, through vague language, leave open the possibility that it could be applied to non-systemically important insurers. Many of the "key attributes" are designed with systemically important entities in mind and their application to non-systemically important entities would be unnecessary and inappropriate.

The document also refers to the potential for "contagion" as a source of systemic risk in the insurance industry and appears to suggest that the risk posed is similar to the "run on the bank" phenomenon that is present in the banking industry. However, such risk is not characteristic of most traditional insurance activities, especially property casualty insurance. Consumers generally do not cancel their insurance when they fear financial market instability. There is no leveraged cash value or investment component to withdraw from a property casualty policy and little to no likelihood of cascading failures from on institution to others. Consumers are legally compelled to purchase some lines of insurance (*e.g.*, auto liability, workers compensation, medical malpractice liability, etc.), and the vast majority of consumers lack the resources to self-insure. Even where insurers are unable to meet the demand for a particular product, residual market mechanisms and public insurance programs (*e.g.*, terrorism and flood in the U.S.) fill the gap.

The *Key Attributes for Resolution of Financial Institutions* document was designed primarily with a banking regulatory regime in mind, and many aspects of it are inappropriate to the insurance industry. Care must therefore be taken that the implementation methodologies employed for applying these KAs to insurers do not result in appropriate and ineffective requirements being imposed on insurers.

The following are responses to certain specific questions raised in the consultative document, *Assessment Methodology for Key Attributes of Effective Resolution Regimes for Financial Institutions*:

22. *Are the general resolution powers specified in KA 3.2, as elaborated in this draft guidance together with the insurance-specific power of portfolio transfer and run-off, as specified in KA 3.7, sufficient for the effective resolution of all insurers that might be systemically important or crucial in failure, irrespective of size and the kind of insurance activities (traditional and 'non-traditional, non-insurance" (NTNI)) that they carry out? What additional powers (if any) might be required?*

The question assumes that insurers can be systemically important or critical in failure even if they are small and regardless of whether they engage in non-traditional or non-insurance activities. In fact, it would be extraordinarily rare for a small insurer to be systemically important and equally rare for an insurer engaged only in traditional insurance activities to be systemically important. The FSB asks whether the powers set forth in the document are sufficient, but a better question might be whether they are all appropriate for insurers that are not systemically important. Many of them are not.

23. *Should the draft guidance distinguish between traditional insurers and those that carry out NTNI activities? If yes, please explain where such a distinction would be appropriate (for example, in relation to powers, resolution planning and resolvability (assessments) and the implications of that distinction.*

The draft should indeed distinguish between traditional insurers and those that carry out NTNI. The implication of the distinction is that traditional insurers do not pose systemic risk and therefore any attempt to impose on traditional insurers a resolution regulatory regime designed for systemically important entities is, by definition, inappropriate. Moreover, the fact that an insurer does engage in NTNI activities does not necessarily make it systemically important. Therefore, resolution regimes designed for systemically important institutions should not be applied to any and every institution engaging in NTNI activities, but must be limited only to those institutions for which a determination of systemic importance has been made.

25. *Is the scope of application to insurers appropriately defined (section 2), having regard to the recognition set out in the preamble to the draft guidance that procedures under ordinary insolvency law may be suitable in many insurance failures and resolution tools are likely to be required less frequently for insurers than for other kinds of financial institutions (such as banks)?*

As described above, the scope of application to insurers is inappropriate to the extent that it can be applied to insurers that are not systemically risky (i.e., "critical in failure"). While it is somewhat encouraging that the preamble acknowledges that existing resolution procedures will be adequate in many cases, this understanding is not always reflected in other parts of the document.

29. *Are there any additional considerations or safeguards that are relevant to the treatment of reinsurers of a failing insurer or reinsurers, particular to:*

(i) the power to transfer reinsurance cover associated with a portfolio transfer (paragraphs 4.7 and 4.8); and

(ii) the power to stay rights of reinsurers to terminate cover (paragraph 4.10)?

PCI objects to 4.4(viii), which allows inwards reinsurance policies to be reduced in value or restructured so as to impose losses on ceding companies. This could have an inappropriate destabilizing effect not only on the ceding insurers affected, but also on the reinsurance industry as a whole as it undermines confidence in the value of reinsurance contracts.

33. *Does this draft Annex meet the overall objective of providing sector-specific details for the implementation of the Key Attributes in relation to resolution regimes for insurers? Are there any other issues in relation to the resolution of insurers that it would be helpful for the FSB to clarify in this guidance?*

Many of the provisions of the Annex do reflect the state-based resolution regime now in place in the United States coupled with new federal requirements imposed on entities designated as systemically important. As previously noted, however, PCI is concerned that the broad wording of the scope of the document could result in requirements that are appropriate only to systemically important entities being imposed on non-systemically important entities. PCI's preference is that the document state clearly that it applies only to entities designated as systemically important.

The document might also benefit from a requirement that regulators contemplating whether to apply the requirements of the KAs to a particular insurer should conduct a cost-benefit analysis to help ensure that the costs of any new regulatory requirements imposed do not exceed the risks posed. This would be especially important if the scope of the document is not narrowed in the way PCI recommends.