Financial Security...for Life.

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The American Council of Life Insurers ("ACLI")[1] appreciates this opportunity to comment on the Financial Stability Board's *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions* consultative document ("Application of the Key Attributes document") dated August 12, 2013.

## General Comments

The United States has a well-established, effective, state-based regulatory system in place to address insurer resolutions. All fifty states, the District of Columbia and Puerto Rico have receivership laws that govern how rehabilitations and liquidations are initiated and operated, including matters relating to proceedings, powers and duties of the receiver, court-approved rehabilitation and liquidation plans, asset recovery, claims and priority of distributions. All of these jurisdictions also have guaranty associations and related laws that address the powers and duties of the association, its board of directors, assessments on member insurers, covered products and the amount of coverage provided to policyholders and contract holders. The National Association of Insurance Commissioners ("NAIC") has adopted model laws that address receiverships and guaranty associations as well as state accreditation standards that relate to each of them.

In addition, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank Act") was passed by both houses of Congress and signed into law by President Obama on July 21, 2010. Title II of this Act creates a new Orderly Liquidation Authority ("OLA") for the dissolution of a failing, systemically important financial company (and certain subsidiaries) when certain conditions are found to exist. If a determination is made to invoke this authority with respect to an insurer, its state regulator has sixty days to file the appropriate judicial action in state court to place the company in liquidation under the laws of that state; otherwise the Federal Deposit Insurance Corporation ("FDIC") is given the authority "to stand in the place of" the state regulator to file such judicial action in state court to place the company in liquidation. In the unlikely event that the FDIC needs to place an insolvent insurer into liquidation, state laws require that

[1] The ACLI is the primary trade association of the life insurance industry in the United States, representing more than 300 legal reserve life insurer and fraternal benefit society member companies that account for over 90% of the assets and premiums of the U.S. life insurance and annuity industry.

its regulator (e.g., commissioner) be appointed as the receiver and that the receivership be conducted under state law.

While we acknowledge that all countries should have effective resolution regimes for large insurers in case of failure, we have several general concerns with the Application of the Key Attributes document as it relates to U.S. insurers, and respectively request that the FSB take them into account as it prepares the next draft.

<u>Its Scope</u>

The *Key Attributes of Effective Resolution Regimes for Financial Institutions* document ("Key Attributes document") dated October 2011 states that "*Any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime that has the attributes set out in this document*". It also states that the resolution regime should require that at least all domestically incorporated global systemically important financial institutions ("G-SIFIs") have in place a recovery and resolution plan, are subject to regular resolvability assessments, and are the subject of institution-specific cross-border cooperation agreements.

The Application of the Key Attributes document applies the scope of the Key Attributes document to insurers by stating on page 9: "*Insurance companies, insurance groups and insurance conglomerates, including reinsurance companies and reinsurance groups (hereinafter "insurers"), that could be systemically significant or critical if they fail therefore should be subject to resolution regimes that meet the standard set out in the Key Attributes*." It also states in 2.1 of Appendix II (Resolution of Insurers) that "*Any insurer that could be systemically significant or critical if it fails and, in particular, all insurers designated as Globally Systemically Important Insurers ("G-SIIs"), should be subject to a resolution regime consistent with the Key Attributes*."

While it is clear that the Key Attributes would apply to insurers who are designated as G-SIIs, it is unclear to whom they would apply when its scope is broadened to include "Any insurer <u>that could be</u> systemically significant or critical if it fails" since (1) such a determination is very subjective and could be interpreted differently by different entities and (2) there is no such listing of insurers as there is with G-SIIs. In order to provide more clarity to whom the Key Attributes would apply to, we suggest that the above-quoted phrase be replaced with "Any insurer <u>that is determined to be</u> systemically significant or critical if it fails".

<u>Ability to Use a Bridge Institution</u>

The Application of the Key Attributes document would give resolution authorities the ability to create and use bridge institutions in order to obtain and hold the viable assets of the insolvent insurer. 4.3 of Appendix II states: "*Resolution authorities should have the power to carry on some or all of the insurance business, either within the existing entity or using a bridge institution, with a view to maximising value for policyholders as a whole and providing continuity of insurance coverage, …*".

In the U.S., bridge institutions are often used in the banking system to resolve failed depository institutions, with the FDIC acting as the receiver. They may also be used by the FDIC under the OLA within Title II of the Dodd-Frank Act in certain situations. The FDIC's preferred Title II resolution strategy entails: (1) placing a troubled systemically important financial institution ("SIFI") into receivership at the parent company level; (2) moving the SIFI's operating subsidiaries (which could include insurers) to a newly capitalized bridge entity; and (3) providing liquidity support, as needed, to the operating subsidiaries, using funds provided by the bridge entity or the Orderly Liquidation Fund.

Bridge institutions, however, are generally not needed or provided for in state receivership laws and therefore not used in insurer insolvencies. We, therefore, suggest that language be added to 4.3 of Appendix II to state that resolution authorities would not be required to create and/or use bridge institutions.

<u>Ability to Restructure Policy Liabilities</u>

4.4 of Appendix II would give resolution authorities the unilateral power "*to restructure or limit liabilities, including insurance and reinsurance liabilities, and allocate losses to creditors and policyholders in a way consistent with the statutory creditor hierarchy, subject to the safeguards set out in KA 5*". Examples of such restructuring include: reducing future (or contingent) benefits; reducing the value of contracts upon surrender; reducing or terminating guarantees; terminating or restructuring options provided to policyholders; and converting one type of insurance liability into another.

The safeguard in 5.1 of Appendix II provides that "*The hierarchy of claims in liquidation should give a high priority to policyholder claims so that shareholders and unsecured creditors, such as debt holders, absorb losses before policyholders*."

In the U.S., state receivership laws do not allow receivers to unilaterally restructure or limit the policy liabilities of an insolvent insurer as it could negatively affect policyholders. This is consistent with U.S. jurisprudence regarding due process and individual property rights. While some receivership courts may allow the restructuring of liabilities when blocks of policies are transferred to a solvent insurer, the affected policyholders have the right to opt out of the transfer. Notwithstanding the safeguard provided in 5.1 of Appendix II, we suggest that language be added to 4.4 of Appendix II to state that resolution authorities would not be required to have the unilateral power to restructure or limit liabilities when such power or concept conflicts with other laws.

<u>Ability to Divide Policyholders into Sub-Classes</u>

5.2 of Appendix II would give resolution authorities the power to create separate sub-classes of policyholders and treat them differently. It states: "*The flexibility for the resolution authority to depart from the general principle of equal (pari passu) treatment of creditors of the same class may extend to the treatment of classes of policyholders if this is necessary to contain the potential impact of a firm's failure, maximise the value for creditors as a whole (including for policyholders) or to otherwise meet the objectives of the resolution, subject to the "no creditor worse off safeguard" (KA 5.2). A resolution authority may define sub-classes of policyholders (for example, policyholders with the same insurance product or those covered by a policyholder protection scheme) and treat those sub-classes of policyholders differently in resolution. However, there should be no* *differential treatment of policyholders within the same sub-class (for example, same insurance product or policies).*"

The "no creditor worse off safeguard" in 5.3 of Appendix II states "*Any determination of whether any class or sub-class of policyholders is worse off as a result of resolution measures than in liquidation should take into account the applicable legal regime and the contractual terms and conditions under the insurance policies*."

State receivership laws in the U.S. generally do not allow or provide for the establishment of different classes of policyholders. While state guaranty association laws provide for different levels of coverage for different products (e.g., $300,000 or $500,000 for life insurance death benefits, $100,000, $250,000 or $500,000 for annuity benefits, $300,000 for property or casualty claims), receivers are not allowed to create sub-classes of policyholders and contract holders and treat them differently (e.g., with regard to payment of claims from the estate of the insolvent insurer). Again, this is consistent with U.S. jurisprudence regarding due process and individual property rights. We, therefore, suggest that language be added to 5.2 of Appendix II to state that resolution authorities would not be required to have the power to create sub-classes of policyholders and treat them differently when such power or concept conflicts with other laws.

**<u>Responses to Questions for Consultation</u>**

Below are our responses to some of the Questions for Consultation that relate to the Resolution of Insurers:

<u>Question 25</u>: *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 institution (such as banks)?*

> <u>ACLI Response</u>: The scope of application to insurers is not appropriately defined. As we commented above, it is unclear to whom the Key Attributes would apply when its scope is broadened to include "Any insurer <u>that could be</u> systemically significant or critical if it fails" since (1) such a determination is very subjective and could be interpreted differently by different entities and (2) there is no such listing of insurers as there is with G-SIIs. In order to provide more clarity to whom the Key Attributes would apply to, we suggest that the above-quoted phrase be replaced with "Any insurer <u>that is determined to be</u> systemically significant or critical if it fails".

<u>Question 26</u>: *Does the draft guidance (section 4) adequately address the specific considerations in the application to insurers of the resolution powers set out in KA 3.2? What additional considerations regarding the application of other powers set out in KA 3.2 should be addressed in this guidance?*

> <u>ACLI Response</u>: With regard to KA 3.2(vii), language should be added to state that resolution authorities would not be required to create and/or use bridge institutions.

Question 27: *Does the draft guidance deal appropriately with the application of powers to write down and restructure liabilities of insurers (paragraphs 4.4 to 4.6)? What additional considerations regarding the application of 'bail-in' to insurers (if any) should be addressed in the draft guidance?*

ACLI Response: As mentioned above, language should be added to state that resolution authorities would not be required to have the unilateral power to restructure or limit liabilities when such power or concept conflicts with other laws.

Question 28*: Is it necessary or desirable for resolution authorities to have the power to temporarily restrict or suspend the exercise of rights by policyholders to withdraw from or change their insurance contracts in order to achieve an effective resolution (paragraph 4.9?*

ACLI Response: We agree with this concept (taking into account appropriate due process concerns), and it is incorporated into states' receivership laws.

Question 29*: Are there any additional considerations or safeguards that are relevant to the treatment of reinsurers of a failing insurer or reinsurer, in 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)?*

ACLI Response: If a receiver has the power to transfer reinsurance, then the proper premiums must be paid for such reinsurance coverage and the treaty terms cannot be unilaterally revised.

Thank you again for the opportunity to comment on the Application of the Key Attributes document. If you have any questions, please feel free to contact me at 00-1-202-624-2135.

Sincerely,

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