GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

10 February 2021

Response to IAIS consultation on draft application paper on resolution powers and planning

Q1. General comment on the draft Application Paper

The Global Federation of Insurance Associations (GFIA) welcomes the opportunity to work with the IAIS on the topic of resolution powers and planning.

It is essential that this work recognises the differences between the banking and insurance business models and therefore applies an approach that is proportionate to the very low relative risk that the insurance industry poses to financial stability.

Resolution powers and planning should make a clear link with the Holistic Framework for Systemic Risk. They should recognise that, in contrast to bank failures, the nature of insurance failures allows portfolio transfer and run-off over a long period of time, which means that a very different set of tools and level of intervention is usually required.

GFIA supports the application of the proportionality principle in order to provide the flexibility needed and minimise the burdens on resolution authorities and insurers.

The Application Paper often uses “should”, which may not be applicable to all jurisdictions, since the resolution authorities in certain of them may not have particular resolution powers available to them, or some of those powers may be unsuitable or inappropriate in certain situations. The Paper should therefore provide for more flexibility, and the industry suggests that the word “could” be used instead of “should” where applicable.

Q12. Comment on section 1.3 Proportionality

The industry supports the application of proportionality. The proportionality principle should ensure that firms are not required to devote significant resources to developing resolution plans when the value of doing so is rather limited and could actually be counter-productive where it acts as a distraction from more effective preventive measures.

If a large number of insurers are required to draft a resolution plan, the industry upholds that proportionate simplifications (eg less content and lower reporting frequency) of the resolution plan are appropriate.

Q13. Comment on paragraph 8

The industry believes that the operational resolution plans need to be tailored to the circumstances of the insurer and with sufficient flexibility to allow the authorities to consider the circumstances of resolution. At the same time, overreliance on resolution plans may divert attention from assessing the causes of a potential crisis and adequate measures to cope with them.

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If a resolution plan is required, the industry agrees that the proportionality principle should be applied as it is being developed and updated.

Q17. Comment on paragraph 11

GFIA suggests specifying the definitions as follow:

- Essential services and functions: Services and/or functions that are critical for the continuation of the insurer. The definition should also take into account that, in some cases, the entire entity does not need to continue. Therefore, it is suggested that the phrase "or the portfolio of insurance contracts written by the insurer in resolution" be added at the end of the existing definition.
- Liquidation: A process to terminate the operations and corporate existence of the entity through which the remaining assets of the insurer will be distributed to its creditors and shareholders or members as appropriate according to the liquidation claims hierarchy, which necessarily involves any intervention by the competent authorities, including where the collective proceedings are terminated by a composition or other analogous measure, whether or not they are founded on insolvency or are voluntary or compulsory. Branches can also be put into liquidation in some jurisdictions, separately from the insurance legal entity to which they belong.
- The terms "solvent run-off" and an "insolvent run-off" may be confusing to some stakeholders, since an insurer may still be able to meet its obligations to policyholders and creditors even if it is deemed to be insolvent because it is unable to meet regulatory capital requirements.

Q32. Comment on paragraph 21

The industry does not think that there is benefit in developing a pre-emptive resolution plan for a solvent insurance company. Besides, GFIA would stress that 1) recovery measures must remain in the hands of the administrative management or supervisory board (with no early intervention by the supervisor), and 2) the plan must be designed and drafted at group level.

In general, it would make sense for resolution authorities to develop a generic overview of resolution options with their pros and cons, in order to facilitate the assessment of the situation and the best course of action. There should be no requirement regarding recovery and resolution plans based on the coverage of the market share of the national market.

Q42. Comment on section 4 Resolution powers

The industry believes that run-offs and portfolio transfers are sufficient to deal with the large majority of insurance failures. Therefore, these should be the preferred tools and authorities should clearly justify the need for more intrusive tools and why run-off or portfolio transfers are not sufficient to meet the objectives of resolution. The industry would also like to re-emphasise that, since failures take longer in insurance than, for instance, in banking, rapid intervention is not a good reason for the choice of resolution tools, especially as fire sales of assets or the crystallisation of their value could result in unnecessary value destruction.

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Q46. Comment on section 4.1 Taking control

A company's strategy and governance structure must be aligned with the market and policyholder needs and be in accordance with relevant laws, regulations and administrative provisions.

The industry is concerned that reasonable and efficient measures, like the centralisation of processes and systems or intra-group transactions, may not be allowed or may even have to be reversed. Such interventions could have far-reaching consequences in areas such as corporate and tax law, but also in terms of investor relations and ratings. Indeed, the concerned insurers could suffer competitive disadvantages in the long-term. Likewise, their policyholders could incur additional costs or loss of returns. Here it is important to again keep in mind that a crisis in insurance business normally allow enough time to implement the necessary crisis measures and remove significant impediments to the resolvability of undertakings. Against this background, interventions in a solvent company by an authority should remain an exception and only take place when absolutely necessary. Such tools would have to be used very carefully and in a transparent way. The resolution authority should closely coordinate with the concerned insurer and first give the insurer the opportunity to propose its own solution for removing the impediment to resolvability.

Q57. Comment on paragraph 42

The prohibition of dividend payments should be carefully analysed and used in exceptional circumstances, as companies set their dividend policy and make dividend decisions very carefully, taking into account their solvency levels, business plan, risk profile and risk appetite, as well as any significant events that could have a material impact.

Many jurisdictional frameworks provide for the possibility to suspend dividends if a company's solvency requirement is breached or if the distribution of dividends would threaten the solvency of the insurer. Additional requirements beyond the current ones, such as a blanket ban on dividends by supervisors, is not necessary or appropriate. Rather, a case-by-case approach would be the right approach to any dividend restrictions and would better recognise jurisdictional differences in employment practices.

Q60. Comment on paragraph 45

The paragraph should reflect jurisdictional differences in employment practices (eg, individual employment contracts are not common in the US).

Q61. Comment on paragraph 46

The paragraph should clarify that it is not suggesting that insurance supervisors should pursue actions aimed at circumventing labour legislation.

Q62. Comment on paragraph 47

The industry is concerned that the paragraph may seem to go beyond the scope of outlining a potential power for limiting payments and transfers for resolution purposes.

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Q76. Comment on section 4.4 Restructuring mechanisms

The industry is concerned that this section may give the impression that unilateral reformation of contracts, which could have significant commercial and legal implications, are normal resolution actions. It believes that the paper should be consistent with what ICP 12 intended — that some of these powers were to be deployed only under extremely limited circumstances, and only if such actions were permitted under a jurisdiction's legal framework.

Q92. Comment on section 4.5 Suspension of rights

Supervisory and/or management actions should be considered when discussing the risk of mass surrender, as such actions can be effective in controlling liquidity risk. More specifically, in many cases insurers have the contractual ability to delay surrenders and/or resolution authorities have the power to apply temporary stays. In fact, it is no coincidence that in markets where products have flexible surrender options, supervisors typically have the power to intervene. Such powers must be taken into account when assessing the actual systemic risk because they serve as an important transmission blocking mechanism.

The industry would like to stress that the power of supervisors to temporarily freeze redemption rights is a potentially useful tool because it can address the remote risk of mass surrender, preserving value and potentially preventing the need to use more drastic measures within the resolution toolkit. Furthermore, it can prevent the unequal treatment of customers who surrender their policy in a crisis and those who do not. Importantly, this tool has proven effective in the few cases when it was used. In conclusion, although mass lapses are extremely unlikely in practice, such powers would create an absolute limit on insurers' exposure to very significant forced fire sales of assets and contagion.

Nevertheless, it is also important to stress that the use of such a tool should only be considered when there is a real and imminent risk of an insurance run (mass lapse); indeed, this strong tool has to be handled with great care, especially when it comes to disclosure, in order to avoid undesirable side effects. In addition, because even temporary freezes constitute an infringement of the property rights of policyholders, they should only be applied under clear and precise conditions that also adhere to relevant case law, such as CJEU jurisprudence in the case of the EU.

Q99. Comment on paragraph 81

The industry considers that this resolution power could be appropriate as long as the ceding company is performing under some types of reinsurance contracts, but it is not reasonable for other types of reinsurance contracts, such as annual renewable contracts, that give reinsurers the unilateral right to terminate for any reason, regardless of whether the ceding company is in resolution.

Where the termination stay is permitted, it is important to introduce adequate safeguards. These include: (1) reinsurers should not be made liable to pay for losses beyond those covered by contracts existing at the time of the loss; (2) to the extent (1) is met, any reinstatement of coverage must be carried out at market prices. In the absence of comparable market prices, the reinsurer should be able to use its existing pricing mechanisms. (3) The stay should not apply where the reinsurer has a unilateral right to terminate regardless of whether the ceding company is in resolution (ie, annual renewable contracts that are designed to give the reinsurer the unilateral right to terminate at the end of the year for any reason).

Reinsurers can provide valuable capacity for offloading risk. Where the implementation of such a framework creates legal uncertainty or moral hazard risks in the case of recovery, this could limit reinsurers' willingness to get involved when firms are in financial difficulty.

Q106. Comment on section 4.7 Resolution powers in ComFrame

In a situation in which the insurer is no longer viable, the power to continue to carry on some of the insurer's business — for example making payments to annuitants — would be consistent with policyholder protection. However, the aim should be to establish appropriate adjustments in value, where required, as soon as practicable, in order to prevent conflicts of interests arising between different policyholder groups. The industry agrees that control, management and operational powers are necessary, but would point out that in insurance, establishing a bridge institution is another way of undertaking a portfolio transfer.

Q120. Comment on section 4.8 Safeguards

The industry agrees with the application of safeguards, but reasonable deviations must be possible.

Q133. Comment on paragraph 109

If a resolution plan is required, the industry agrees that the proportionality principle should be applied as it is being developed and updated.

Q163. Comment on paragraph 132

It should be noted that "fast-moving" resolutions are rare in the insurance sector.

Q177. Comment on paragraph 144

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Q185. Comment on paragraph 151

The list of stakeholders included in the communications strategy for a resolution plan should be decided on a case-by-case basis. Each communication strategy will be informed by the factors causing the stress, the strategy employed in the resolution and any relevant legal constraints. It may often be premature to plan these in advance with any degree of specificity. Furthermore, regulators are likely to want to differentiate between what information is necessary to execute the resolution and the type of information that would need to be communicated to broader stakeholder groups.

Q209. Comment on paragraph 171

As stated by the IAIS, it is essential to take existing legislation into consideration. To that extent, in some jurisdictions in Europe, insurance guarantee schemes are last-resort mechanisms providing additional protection after all resources from the insurance undertaking have been exhausted and they should remain that way.

In the US, however, state-based guaranty associations do more than just assess their member insurers and remit payments to covered policyholders during the liquidation of an insolvent insurer. They play a much more important role in the resolution of an insurer, both before and during a liquidation. Accordingly, resolution authorities, supervisors and crisis management groups should coordinate and cooperate with guaranty associations in order to develop sound resolution strategies provided that the necessary confidentiality concerns are effectively addressed.

Q227. Comment on the Annex: Examples of relevant legislation on resolution powers

The Annex only addresses resolution powers and legislation in four countries, so it appears to be incomplete. Furthermore, in the US section, it focuses on the NAIC's Insurer Receivership Model Act (IRMA), even though it has only been adopted in two states (Utah, Texas). This section should also address the IRMA's predecessor, the Insurers Rehabilitation and Liquidation Model Act, which has been adopted by many more states, either in whole or in part.

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About GFIA

The Global Federation of Insurance Associations (GFIA), established in October 2012, represents through its 41 member associations and 1 observer association the interests of insurers and reinsurers in 64 countries. These companies account for 89% of total insurance premiums worldwide, amounting to more than $4 trillion. GFIA is incorporated in Switzerland and its secretariat is based in Brussels.