

April 14, 2023



Dr. Victoria Saporta
Chair, Executive Committee
Mr. Jonathan Dixon
Secretary General
International Association of Insurance Supervisors (IAIS)
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: IAIS Draft Issues Paper on Roles and Functioning of Policyholder Protection Schemes

Dear Dr. Saporta and Mr. Dixon:

The insurance members of the Institute of International Finance (IIF) are pleased to respond to the IAIS's Public Consultation on a Draft Issues Paper (Draft Issues Paper) on the Roles and Functioning of Policyholder Protection Schemes (PPS). We understand the interest of the IAIS in updating its 2013 Issues Paper on this topic, and in developing a compendium of current practices for PPS that serve as a reference for jurisdictions establishing or modifying PPS. In this letter, we would like to put forward several suggestions for better balancing the regulatory and political considerations that are inherent in developing PPS.

Overarching Comments

If a Jurisdiction Elects to Adopt a PPS, the Design and Implementation of the PPS Should Be Flexible, Reflecting Jurisdictional Specificities. We appreciate that the IAIS notes that the Insurance Core Principles (ICP) and ComFrame do not create an expectation¹ that jurisdictions have PPS in place.

The final Issues Paper should refrain from making any statements that could be construed as negatively impacting flexibility for jurisdictions electing to adopt a PPS and should explicitly acknowledge the need for flexibility in the design and implementation of PPS for jurisdictions that elect to adopt one. Specifically, flexibility should be preserved in the design and implementation of any PPS in order to reflect the local or regional industry and markets and the political, legal, and supervisory specificities of the jurisdiction.

The decision as to whether to establish a PPS are often grounded in political considerations, as are many aspects of key design elements, most notably PPS funding sources, the scope of coverage and home/host jurisdiction issues. Jurisdictions have to weigh carefully the needs of policyholders that are covered by the PPS, the classes of policies that are covered, as well as coverage limits.

¹ Given that the ICPs and ComFrame are principles, standards and guidance, the use of the term 'create an expectation' is more accurate than the use of the term 'require' in Paragraph 5 of the Draft Issues Paper.

The Discussion of Moral Hazard in the Draft Issues Paper Would Benefit from Greater Nuance.

Moral hazard can arise from the decisions that underlie a determination by a jurisdiction to establish a PPS as well as the design features that are implemented. The IAIS could further explore these political aspects of moral hazard in the final version of the Issues Paper.

The discussion of moral hazard in Annex 1 would benefit from a greater focus on the insurance industry, as much of the discussion appears more relevant to the banking sector. It should also be bolstered by evidence that support the observations made, and the assumptions underlying those observations. This evidence would improve the Annex, which, at present, appears to provide differing viewpoints without reaching a firm conclusion.

For example, we note that in some jurisdictions, the customer journey is specifically designed so that the existence of PPS is not disclosed in the marketing phase of customer contact in order to reduce the moral hazard and to incentivize customers to choose policies based on the reputation of the insurer in addition to pricing and coverage considerations. In other jurisdictions, insurers are required to make disclosures relating to their financial condition as an aid to customers' understanding of the financial soundness of the insurer. The IAIS could suggest to jurisdictional supervisors that they may wish to further explore the extent to which efforts to increase the information that is provided to prospective customers on the condition and solvency of the insurers in their markets and/or the existence of PPS, and the timing of that disclosure, may impact moral hazard. Supervisors may also wish to consider the extent to which various types of policyholders have the ability to assess the financial and solvency standing of the insurers offering products and services (or to engage a broker or agent to make this assessment).

We would also note that, in Annex 1, the discussion of intermediaries does not recognize the incentives that market intermediaries have to recommend strong insurers to their clients in order to facilitate a good reputation for recommending appropriate and suitable products and services. Moreover, intermediaries that have a market-wide view are, in general, better placed than their clients, to assess the financial soundness and solvency of an insurer. Similarly, the statement that a PPS may result in reduced supervisory vigor does not recognize the incentives to reduce reputational damage and to preserve the supervisors' good standing amongst its peers and in supervisory colleges.

We ask the IAIS to remove Paragraph 84 in the final version of the Issues Paper as it overstates the potential for customers to purchase policies based on price alone based on knowledge of PPS coverage. We also believe that this Paragraph overstates the incentive for insurers to price aggressively and to assume risks that threaten financial soundness. Insurers generally do not conduct their business in a manner that would impede future viability.

If a PPS is Established, Ex-Post Funding is Preferable to Ex-Ante Funding or Policyholder Surcharges.

When a decision is made to establish a PPS, the IIF has long encouraged the use of ex-post funding for several reasons. In general, given the rare incidence of insurer failures and the burden of ex-ante funding mechanisms, we are of the view that ex-post funding approaches are more appropriate.

The use of ex-post funding avoids the issue of trapped assets that may never be needed for an insurer resolution or only needed many years in the future. As the IIF has noted in a number of past submissions to the IAIS and other standard setters, insurance resolutions are rare and generally proceed over several

years through mechanisms such as run-off or portfolio transfer. [Statistics on the use of PPS funding for resolution over the past 10 or 20 years would be helpful.]

The combination of ex-ante PPS and prudential capital requirements may result in an excessive level of prudence that may limit the ability of insurers to provide products and services to their customers.

Paragraph 76 discusses funding of PPS by policyholder surcharges. It should be recognized that PPS in general impose costs on policyholders – either directly or indirectly. These costs should be weighed against the benefits of the additional protection provided.

With respect to the discussion of risk-based levies in Paragraph 82, we note that size and premiums are not necessarily indicative of risk. We agree with the IAIS's statement in Paragraph 85 that risk-based contributions are not straightforward to design and calibrate.

In Order to Provide for Accountability, Jurisdictions that Elect to Establish PPS Should Clearly Delineate the Roles and Responsibilities of Supervisors, Resolution Authorities and Authorities Responsible for PPS. We encourage the IAIS to note the need for jurisdictions to provide a clear delineation of the respective roles and responsibilities of supervisors, resolution authorities and authorities responsible for PPS. The IAIS should not describe or assign those roles and responsibilities, which should remain subject to jurisdictional discretion based on the supervisory, resolution and PPS frameworks in a particular jurisdiction. Greater clarity on the respective powers of various authorities can facilitate accountability, reduce overlap or overreach, and provide greater clarity to insurers headquartered or operating in a particular jurisdiction.

Paragraph 16 notes that there have been suggestions that a PPS could have a role in resolution planning, especially in the case of systemically important insurers. We note the need for clarity on the roles and responsibilities of the resolution authority and the PPS in such a situation.

Any Role for Resolution Authorities and Authorities Responsible for PPS in Insurers' Recovery Should Be Carefully Considered. Paragraphs 16 and 25 suggests that a PPS could be used for recovery or to improve the chance of recovery of the insurer, without providing a description of how PPS have been used in various jurisdictions in support of recovery or specifying the actions that a PPS could take in furtherance of recovery. Under most circumstances, responsibility for recovery should remain in the first instance with the board of directors and senior management of the insurer, with appropriate communication with and oversight by the relevant supervisory authority or group supervisor. In exceptional circumstances (e.g. fraud or wrongdoing), the authorities responsible for PPS and resolution may need to become involved in the recovery stage but should do so according to the delineated roles and responsibilities discussed in the foregoing paragraph. Moreover, the final Issues Paper should note that early regulatory or supervisory intervention in the recovery phase may result in inappropriate involvement in matters that are the responsibility of the board of directors or senior management of the insurer.

In some cases, actions are taken by the resolution authority and/or authorities responsible for PPS in an effort to remove impediments to resolution. While well intentioned, these actions can be overbroad and can inhibit the ability of the insurer to return to a business-as-usual condition, which could lead to

avoidable resolution scenarios. We have particular concern about actions to change business strategies, the structure of a group, or the management of the group (in the last case, absent fraud or wrongdoing). As we noted in our response to the IAIS Application Paper on Resolution Powers and Planning,² communication about actions taken by the authorities must include the insurer in order to ensure that those actions are appropriate, effective, and support the goal of restoring the insurer to viability.

We appreciate the opportunity to comment on the Draft Issues Paper and welcome the opportunity for further dialogue on these important issues.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeff Monroe", with a long horizontal flourish extending to the right.

² https://www.iif.com/portals/0/Files/content/Regulatory/02_05_2021_resolution_powers_response.pdf