

February 4, 2021

Dr. Victoria Saporta
Chairperson
Mr. Jonathan Dixon
Secretary General
International Association of Insurance Supervisors (IAIS)
Centralbahnplatz 2
CH-4002 Basel
Switzerland



Re: IAIS Application Paper on Resolution Powers and Planning

Dear Dr. Saporta and Mr. Dixon:

The IIF and its insurance members are pleased to respond to the IAIS Application Paper on Resolution Powers and Planning (Application Paper). We appreciate the need for supervisory guidance on resolution planning and the practical application of resolution powers. We commend the IAIS for highlighting the critical importance of cooperation and coordination between authorities when planning for and exercising those powers.

Overarching Comments

The IAIS ties the extensive and detailed guidance in the Application Paper to a broad set of objectives of a resolution framework: policyholder protection, contributing to financial stability, minimizing the reliance on public funding, ensuring the continuity of critical operations, reinforcing market discipline, and preventing large negative effects on society. We encourage the IAIS to refine and prioritize the objectives that underlie the Application Paper and focus the guidance on ICP 12, *Exit from the Market and Resolution*, recognizing that jurisdictions are at different stages of implementation of the ICPs and that a variety of tools and methods may be used in implementing ICP 12 in a proportionate and flexible manner (as emphasized in ICP 12.7). Moreover, given jurisdictional differences in legal and supervisory processes for resolving an insurance company, guidance relating to resolution powers and planning should be illustrative in nature, rather than prescriptive rules. Recovery and resolution are outcomes, not specific processes. The Application Paper should be outcomes-focused, rather than focused on the approaches that can be used to achieve the outcomes, and should support jurisdictional discretion.

The Application Paper should note explicitly that insurers generally do not fail suddenly or in a disorderly manner and that bank 'runs' are not a feature of insurance company distress scenarios. Insurers often have the opportunity to take proactive recovery efforts to avoid resolution. We encourage the IAIS to acknowledge the greater scope for recovery efforts to succeed in the insurance context by focusing its attention on recovery, as opposed to resolution, planning efforts.

Where resolution ultimately is required, insurance group supervisors have ample time to engage with the company and relevant jurisdictional supervisors and any crisis management group (CMG) that may be in place in order to plan an appropriate course of action and to implement that plan. In most cases, insurers enter into run off or portfolio transfer arrangements, during which existing contractual obligations remain in place and policyholders typically remain fully insured until the end of the contract term. This type of

orderly resolution is characteristic of insurers, and does not unduly negatively impact policyholders or the real economy. As a result, bank-like resolution measures or approaches are not necessary or appropriate for the insurance business model.

Communication among the group supervisor, the company, relevant jurisdictional supervisors, and any CMG is needed in order to coordinate efforts around recovery planning. Failure to include the company in communications could render recovery efforts ineffective, while failure to include the relevant jurisdictional supervisors in communications could result in uncoordinated actions being taken.

Insurance products and services are highly substitutable and operate in a highly competitive market. As such, insurance policies are not comparable to bank savings or checking accounts, as insurance products have disincentives to surrender such as penalties or adverse tax consequences and alternatives to surrender exist (e.g. policy loans). Unlike banks, insurers are not typically subject to ‘runs’ that give rise to acute liquidity pressures, mass policy surrenders are extremely rare (as the IAIS acknowledges), and the interconnectedness of the sector is more limited than in the banking sector. That being the case, Paragraph 21 should be deleted or substantially amended to reflect the extremely low risk of disorderly failure, the limited interconnectedness of the sector, and the ready substitutability of most insurance products. Moreover, each of these factors points to a greater emphasis on recovery strategies as opposed to resolution plans for insurers.

ICP 12 notes that the term ‘resolution’ encompasses options including portfolio transfer, run-off, restructuring, and voluntary exit from the market in addition to liquidation, and notes that resolution mechanisms can be applied to one or more separate entities within the group. Additionally, the introduction to Annex 2 to the Financial Stability Board’s (FSB) *Key Attributes of Effective Resolution Regimes for Financial Institutions*¹ (2014 Annex) notes that “[t]he general assumption is that traditional insurance activities and even some non-traditional insurance activities that are no longer viable will typically be resolved through run-off and portfolio transfer procedures.” Section 4.2 of the 2014 Annex states that resolution authorities should have a wide range of powers but should only use those powers that are “suitable and necessary,” taking into account insurance specificities. We encourage the IAIS to focus on these broader options for recovery, as opposed to resolution, planning efforts, which have been used successfully in the insurance context to address entities in distress.

We note that the Application Paper is intended to provide guidance to resolution authorities that are not insurance supervisors. We note that this may raise issues of proper jurisdiction, especially if those authorities are not also supervisors or regulators (e.g. in some jurisdictions, the resolution authority may be a court of law).

Specific Comments

Objectives and concepts of resolution of insurers

Section 2 of the Application Paper references ICP 12 and notes that exit from the market can occur voluntarily or involuntarily, when all other preventive or corrective measures (see ICP 10) are inadequate to preserve or restore an insurer’s viability. Supervisors should be directed to exhaust all options short of involuntary exit, which should be characterized as a very extraordinary measure. As part of exhausting all

¹ See FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, https://www.fsb.org/wp-content/uploads/r_141015.pdf

options short of involuntary exit, the group or lead supervisor should be in close communication with the board and senior management of a distressed insurer. This would allow the supervisor to better understand and take into consideration any efforts by the insurer to implement recovery measures.

As noted in our comments below regarding resolution plans, if and when a resolution plan is required, the group supervisor and any CMG should establish a resolution plan for the material entities within the group. Resolution plans should be outcomes-focused and should not be overly detailed, reflecting the need to maintain flexibility and to focus on recovery measures in the first instance. We note that the recent FSB work on resolution² has focused primarily on resiliency at the firm level, which aligns with a focus on recovery in the first instance, and on financial stability at the macro level.

While we understand the statement in Paragraph 29 that there are risks of undue interference or delay from consultation with a range of stakeholders, the benefits of broader consultation should outweigh the risks in the majority of cases. This consultation should always include the board and senior management of the distressed insurer. We encourage insurance supervisors to consult broadly in order to avoid hasty decisions that may not be based on a full understanding of all of the relevant facts. The fact that insurers generally do not fail in a rapid or disorderly manner affords time to pursue recovery measures to avoid resolution. Where resolution ultimately is required, supervisors and any CMG have more time to take carefully considered action in consultation with the affected company and relevant stakeholders.

Paragraph 22 states that any public funding used for the resolution of the insurer should be recouped from the insurance sector in order to strengthen market discipline. We believe that the issue of public funding is best addressed by legislatures in the respective jurisdictions.

Entry into resolution

We appreciate the statement in Paragraph 26 that jurisdictions should articulate clear standards or suitable indicators of non-viability to guide decisions as to whether the conditions for resolution have been met. Standards and indicators should include both quantitative and qualitative factors that reflect the totality of the circumstances surrounding the distress of an insurer. This Paragraph should reference ICP 12.0.9, which states that, “[n]o uniform, single fixed point of non-viability can be defined that will be appropriate for the application of resolution measures in all circumstances. Whether to apply resolution measures, and the type of measures implemented, will depend upon the factual circumstances of the particular resolution scenario.”

Supervisors should be encouraged to take the least intrusive actions, in a ladder of intervention, when a company is in a stressed condition, and should engage with senior management of the company to understand and support the company’s proactive corrective actions, such as portfolio transfer, to address stressed conditions. Communication between the group supervisor, the CMG (if one is established), relevant jurisdictional supervisors, and the management of the distressed company is critical for helping ensure that the supervisory actions taken are appropriate, proportionate, and in the best interests of the company’s policyholders. In the first instance, the focus should be on recovery as opposed to resolution.

² See FSB 2020 Resolution Report, <https://www.fsb.org/wp-content/uploads/P181120.pdf>, Implementation and Effects of the G20 Financial Regulatory Reforms, <https://www.fsb.org/wp-content/uploads/P131120-1.pdf>, and Key Attributes Assessment Methodology for the Insurance Sector, <https://www.fsb.org/wp-content/uploads/P250820-1.pdf>

Box 1 lists illustrative examples of resolution conditions. We caution that using some of these examples as a checklist of conditions under which an insurer should be resolved could lead to premature and inappropriate action to resolve an insurer before exhausting all other preventive or corrective measures to restore an insurer's viability. For example, a rapid rise in credit default swap (CDS) spreads or a rapid and sustained decline in share price or market activity may reflect market conditions and volatility more broadly. CDS spreads are prone to increasing excessively in a stress event, implying inappropriately high default probabilities, and later reverting to more normal levels. These conditions should give rise to prompt discussion among the relevant supervisors or within the supervisory college or CMG. These discussions may or may not result in a determination that resolution is the optimal course of action.

Governance or risk management and control deficiencies can and should be addressed through supervisory dialogue with senior management and the board of the insurer. In the extreme, these deficiencies may ultimately lead to the need for resolution, especially if fraud or criminal activity is present. However, in most cases, a less severe and intrusive solution can be effective.

Resolution powers

Paragraph 32 lists 'taking control' as the first item in a list of resolution powers. We would place this power last in the ladder of intervention, as it is an extreme power that could complicate or impede the company's efforts at recovery from stress. Whether in recovery or resolution mode, company senior management and technical experts have a wealth of information that they can share with the relevant supervisors including risk exposures and how they are managed, liquidity and capital positions, and the impact of the stress on different entities within an insurance group. Taking control of the insurer could result in supervisory decisions and actions that do not take into consideration all relevant information.

The guidance on resolution powers should better reflect the fact that legal frameworks and jurisdictional powers and tools can vary significantly. As well, the nature of the insurance business, and its key risks and exposures, may vary by jurisdiction and call for the application of different recovery or resolution tools. A sharper focus on flexibility and proportionality, consistent with ICP 12.7, would help to reflect these jurisdictional specificities.

Paragraph 32 also references the power to provide continuity of essential services and functions. We have discussed in our responses to prior consultations³ that there are very few essential functions performed by insurers (in contrast to banks). Essential services and functions, if any, should focus only on those activities that could have a material impact on the functioning of both the financial system and the real economy. This would be consistent with the statement in the 2014 FSB consultation that a resolution strategy should take into account the materiality and the potential impact that the failure to provide a certain function could have on the financial system and the functioning of the real economy. A sharper focus on activities that could have a material impact would also be consistent with the statement in the 2014 FSB consultation that the annex to that guidance provides *indicative* lists of functions that could exhibit some degree of criticality, and that authorities need to undertake their own assessments for each firm.

³ IIF and Geneva Association response, https://www.genevaassociation.org/sites/default/files/research-topics-document-type/pdf_public//ga-2014-ga-iif-answer-recovery-resolution-planning.pdf to FSB consultation on Recovery and Resolution Planning for Systemically Important Insurers, December 10, 2014, https://www.fsb.org/wp-content/uploads/c_141016.pdf (2014 FSB consultation).

The concept of essential services and functions in the insurance context should also recognize that insurers fail rarely and, unlike banks, when they do fail, their demise is slow and gradual. Furthermore, the highly competitive and unconcentrated nature of the insurance market provides for ready substitutes of insurance products and services. Contractual obligations generally remain in place through a run-off or portfolio transfer.

We recommend the deletion of Paragraphs 46, 47, and 48 regarding the prohibition of the payment of variable remuneration. The treatment of claw-back provisions varies considerably among jurisdictions and, as the IAIS acknowledges, any supervisory action to prohibit payment or claw back compensation may be restricted by legislation. Therefore, general supervisory guidance on this topic may not be actionable. Moreover, it is unclear at which level of the group the prohibition or claw-back would apply if only one part of the group is in need of resolution. The following section, which addresses prohibitions on the transfer of assets, properly focuses on the high-level goal of preserving the assets of a company in distress, including funds use to pay variable remuneration.

Paragraphs 90 through 93 reference the power to establish a bridge institution, which is a structure more commonly used in a single point of entry bank resolution, and where prompt action is needed to ensure an orderly wind-down. Given the existence of other tools for insurers, such as portfolio transfer, we do not believe that an emphasis on bridge institutions in the Application Paper is warranted. We also note and welcome the IAIS's statement that, for insurers, both single point of entry and multiple points of entry frameworks are appropriate.

We would revise the wording of Paragraph 91 to state that, where legislation provides for the establishment of a bridge institution, the legislation should call upon the insurance supervisory authority to establish provisions and arrangements for the management of the bridge institution. We would recommend the deletion of Paragraph 93, as these specific powers are highly dependent upon national legislative frameworks. The general statement made in Paragraph 92 encompasses the more detailed provisions discussed in Paragraph 93.

We would also delete the last two sentences of Paragraph 94 that may suggest that legislation should mandate that an insurer's contracts with third parties should prohibit cancellation in the event of a resolution. A requirement to include this language across a wide range of vendor contracts would substantially increase the cost to insurers of obtaining needed products and services, and would require across-the-board contract amendments, the costs of which would outweigh any potential benefits. More generally, guidance on the provisions that should or should not be contained in insurance legislation goes beyond supervisory powers.

Resolution plans

The group supervisor, and other CMG members where applicable, should have the sole responsibility for establishing and executing a resolution plan for the material entities of the group except where legislation assigns that role to another resolution authority. The group supervisor should seek to coordinate with any non-insurance authority that has legislative authority for the resolution of an insurance group. Local insurance supervisors should not be permitted to develop entity-level resolution plans for a firm that is a member of an insurance group.

Where it is responsible for the establishment and execution of the resolution plan, the group supervisor should coordinate communication among the local insurance supervisors and take a leading role in the supervisory college and any CMG. We appreciate the description in Paragraphs 184 and 185 of the relationships and communication protocols among the group supervisor, the supervisory college, and the CMG.

We agree fully with the statements in Paragraph 182 that emphasize the importance of a coordinated communications strategy and the alignment of communications during a crisis. We would urge the IAIS to issue a stronger statement in Paragraph 149 regarding the confidentiality of communications by stating that, in general, when recovery or resolution plans are being formulated or implemented, communications among supervisors, and between supervisors and the affected firm, should be held in strict confidence, absent any legal requirements requiring reporting or disclosure.

We recognize that, in some jurisdictions, the insurer itself is responsible for establishing a resolution plan. We note that requiring the insurer to develop a resolution plan requires the insurer to anticipate what measures could be taken at the point of non-viability, an exercise that is difficult at best to conduct in advance of any specific distress actually materializing and unlikely to result in any actionable plan. While insurers conduct extensive scenario analysis for risk management purposes, they generally do not conduct these analyses under a resolution scenario.

The specific risks to which the insurer is exposed, the functions it provides, and the potential systemic impact of its failure may change over time, limiting the usefulness of extensive *ex ante* planning.

Importantly, as noted in Paragraph 112, the group supervisor should leverage the information that is available from local supervisors and public sources before issuing an information request to the insurer. This not only promotes efficiency but allows the distressed insurer to focus on any possible recovery strategies that may be available to avert resolution.

The group supervisor should be in close communication with the board and senior management of a distressed insurer in order to understand and to take into consideration in the establishment of the resolution plan any efforts by the insurer to implement its recovery measures.

Paragraph 122 states that the resolution plan should allow an assessment of its feasibility and credibility in light of the likely impact of the insurer's failure on the financial system and real economy, taking into account the financial and economic functions that need to be continued to achieve the resolution objective. As noted above, insurers perform very few, if any, critical financial and economic functions. Moreover, few, if any, forms of insurance coverage would have cascading negative effects on the financial system and the real economy if withdrawn. Insurance coverage that might be withdrawn by one carrier would be readily substituted by other insurers if the coverage is commercially viable.

More generally, Paragraph 122 and the following section 5.4.4 should be reflected in the Holistic Framework and guidance on macroprudential supervision rather than in guidance on resolution plans. We would also encourage any analysis of potential financial stability impacts to seek input from a wider range of stakeholders, including those with specific responsibility for financial stability. We therefore request that the 4th bullet under Paragraph 114 and Paragraphs 122-125 respectively, which go beyond the guidance provided in ICP 12 or related ComFrame provisions, be deleted. These stakeholders may reside outside of the insurance supervisory authority.

We would qualify the statement in Paragraph 144 that timing is critical in the ability of resolution plans to achieve their objectives. As we have noted above, in the rare event of an insurer's failure, the failure is in nearly all cases gradual and orderly. Events and stressors generally do not materialize on short notice. Supervisors and CMGs have time to take measured and considered action in coordination with senior management of the distressed company. We would delete the first two sentences of this Paragraph and incorporate into Paragraph 144 the final sentence that discusses clear governance policies and procedures. Similarly, we would delete the reference in Paragraph 107 to an "over the weekend" resolution.

In Paragraph 162, we would rephrase the focus on 'regular' assessments of resolution plans to focus on a reassessment when a material change has occurred to the company's business model, corporate structure, operations, or product offerings.

Resolvability assessments

We note that ComFrame 12.3.b.1 calls for the group supervisor to undertake resolvability assessments at the level of those entities where it is expected that resolution actions would be taken. The IAIS should reflect this element of ComFrame in the Application Paper in order to avoid any impression that a resolvability assessment would necessarily need to include the entire IAIG.

We would urge the IAIS to shift the focus of resolvability assessments in the Application Paper to situations where there has been a material change in the business structure of an insurer, again, consistent with ComFrame 12.3.b.. To require these assessments more broadly could impose undue burden on both insurers and insurance supervisors.

Paragraph 165 states that a resolvability assessment should identify any impediments to resolution that could arise from the legal or operational structure of the firm. Paragraph 164 states that, where impediments are identified, authorities should have in place a process for requesting that the insurer take prospective action to correct those impediments. While material impediments to resolution could require prospective correction, we caution against any approach that substitutes the judgment of the insurer's board and senior management for the views of supervisors with respect to the insurer's business practices, legal, operational or financial structure, or organization. These matters are properly within the purview of the insurer's board and senior management, and there should be a high bar for supervisory interference in these business decisions. We would emphasize the language in ComFrame 12.3.b.4, which is referenced in Paragraph 167: "When the resolution plan and/or resolvability assessment identifies potential barriers to effective resolution, the IAIG may be given the opportunity to propose its own prospective actions to improve its resolvability by mitigating these barriers." We would go further and encourage supervisors to look to the IAIG in the first instance to both identify potential enhancements to its resolvability and address material impediments to resolvability.

Paragraph 163 also notes that resolvability assessments could benefit from simulation exercises working through the resolution plan in a time-accelerated exercise with relevant key persons. It is not clear whether the relevant key persons refer to supervisors or to key persons within the insurer. In either case, the costs of such intensive exercises should be weighed carefully against any perceived benefits. In the first instance, we would encourage supervisors to consider the results of stress testing, scenario analyses, or testing of contingency or recovery plans conducted by the insurer, before commencing supervisory simulation exercises.

Cooperation and coordination

We reiterate our comments above regarding the importance of communication with the company, all relevant supervisors, and the CMG during any recovery or resolution process. Effective and timely communication helps to prevent unintended consequences from uncoordinated actions that can be to the detriment of a company's policyholders and the insurance markets.

Conclusion

We appreciate the opportunity to comment on this Application Paper and the important issues it raises. We would welcome additional stakeholder engagement on the topic of recovery and resolution in the insurance industry.

Respectfully submitted,

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

Mary Frances Monroe