

Draft Annex to the FSB Key Attributes: Resolution of Insurers

The FSB Key Attributes of Effective Resolution Regimes for Financial Institutions (the Key Attributes) state that any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime consistent with the Key Attributes.

The systemic impact of an insurance failure can materialise in various ways, including through contagion (where policyholders or markets consider that similar problems may exist in similar products from other insurers) and financial links (for example, in the derivatives markets), and may have an impact on the broader economy through a failure to make good on promises to policyholders or to engage in new transactions that would foster economic activity.

The 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. It may not be possible, however, to rely on these tools in all circumstances, and particularly in those cases in which the business model, booking model or shared services model of a firm is complex. Run-off and portfolio transfer tools may not, for example, be sufficient to mitigate the systemic impact of a sudden deterioration in the viability of a larger, complex insurance group engaging in other non-traditional insurance and non-insurance activities that may involve some degree of bank-like leverage and maturity transformation. 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 therefore be subject to resolution regimes that meet the standard set out in the Key Attributes.

This Annex provides guidance on the implementation of the Key Attributes in relation to resolution regimes for insurers. It supplements the Key Attributes by indicating how particular Key Attributes, or elements of particular Key Attributes, should be interpreted when applied to resolution regimes for insurers. The guidance on individual Key Attributes should be read in conjunction with the Key Attribute to which it relates.

1. Objectives

1.1 A resolution regime for insurers should meet the general objectives set out in the Key Attributes (Preamble and Key Attribute 2.3). It should make it feasible to resolve an insurer without severe systemic disruption or exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation. Additionally the resolution regime should have as a statutory objective the protection of insurance policyholders, especially retail policyholders who are dependent on insurance benefit payments.

1.2 Functions provided by insurers that may constitute vital economic functions include risk transfer, risk pooling and the pooling of savings. The protection of these functions should include securing appropriate continuity of insurance coverage and payments.

2. Scope of resolution regimes

2.1 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.

3. Resolution authority

3.1 As part of its statutory objectives and functions, the authority responsible for the resolution of insurers should exercise its resolution functions in a way that meets the relevant general objectives set out in the Preamble and Key Attribute 2.3 and the specific objective of protecting policyholders.

3.2 To achieve its objectives, the resolution authority may need to interact with applicable schemes for the protection of insurance policyholders (‘policyholder protection schemes’). The respective mandates, roles and responsibilities of the resolution authority and policyholder protection schemes should be clearly defined and coordinated.

3.3 The resolution powers may be exercised by the resolution authority directly or through a special administrator, receiver, conservator or other official subject to the same objectives as the resolution authority.

4. Resolution powers

Entry into resolution (Key Attribute 3.1)

4.1 The resolution regime should set out clear standards or suitable indicators of non-viability to guide the decision as to whether an insurer meets the conditions for entry into resolution. Such standards or indicators should allow for timely and early entry into resolution before an insurer is balance-sheet insolvent. They may include a determination by the supervisory authority, in consultation with the resolution authority (where the supervisory authority is not also the resolution authority) that:

- (i) there is an unacceptably low probability that policyholders will receive payments as they fall due;
- (ii) there is an unacceptably low probability that policyholders receive payments of the total amount owed;
- (iii) recovery measures have failed to return the insurer to sustainable viability or have not been implemented in a timely manner;
- (iv) proposed recovery measures will not be sufficient to return the insurer to viability or cannot be implemented in a timely manner; and
- (v) the resolution objectives cannot be achieved through ordinary insolvency, run-off or portfolio transfer procedures alone.

Choice of resolution powers

4.2 Resolution authorities should have at their disposal a broad range of resolution powers, but should in each case only use those powers that are suitable and necessary to meet the resolution objectives. The choice and application of the resolution powers provided for in KA 3 should take into account insurance specificities and, in particular, the types of business the insurer engages in and the nature of its assets and liabilities.

Control, manage and operate the insurer or bridge institution (Key Attribute 3.2 (ii, iii and iv))

4.3 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, including the power to:

- (i) continue to fulfil in whole or in part existing obligations under contracts of insurance;
- (ii) permit the exercise of options under existing contracts of insurance, including the surrender or withdrawal of contract cash value;
- (iii) enter into new contracts of insurance and reinsurance; and
- (iv) buy reinsurance (or retrocession) coverage.

In each case, the costs of those obligations should be met either from the existing estate, the collection of premiums due, the collection of recurring premiums, the collection of new premiums or the support of the policyholder protection scheme.

Restructuring of liabilities (Key Attribute 3.2 (iii))

4.4 The resolution authority should have the 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 Key Attribute 5. Examples of a restructuring of liabilities include, but are not limited to, the following:

- (i) reducing future (or contingent) benefits, such as the sum assured or the annuity provided, in a manner that allocates losses as appropriate to policyholders whilst maintaining continuity of insurance coverage and payments falling due;
- (ii) reducing the value of contracts upon surrender, where insurance contracts have a surrender value to enable losses to be imposed as appropriate on policyholders that seek to surrender their contracts;
- (iii) reducing or terminating guarantees, such as the guaranteed sum assured or annuity rate provided by a with-profits policy, to enable losses to be imposed on policyholders that participate in the profits and losses of the insurer (or a fund) as appropriate and remove uncertainty about the future value of such guarantees;
- (iv) terminating or restructuring options provided to policyholders, for example as part of a deferred or variable annuity contract (including to help facilitate a transfer);
- (v) converting an annuity into a lump sum payment that can be used to fund the issuance of a new annuity contract or be paid out to the policyholder in circumstances where continuity is not achievable;
- (vi) settling crystallised and contingent insurance obligations by payment of an amount calculated as a proportion of estimated present and future claims, to provide a more rapid and cost-effective resolution where future claims are uncertain and run-off is not feasible or there is not time to carry out a detailed actuarial valuation;
- (vii) converting insurance liabilities from one type of insurance liability into another (for instance 'with profits' into 'unit linked') in order to facilitate a sale of business or ensure its continuity;
- (viii) reducing the value of inwards reinsurance contracts or restructuring inwards reinsurance contracts, for example by imposing limits on a policy, to allow losses to be imposed on cedants, as appropriate and where this does not compromise financial stability. This includes obligations under inwards reinsurance contracts.

Where a restructuring of insurance liabilities takes place and the values of insurance contracts are reduced, that restructuring may provide for the values of insurance contracts to be increased later in relation to the performance of the business following resolution so that creditors (including policyholders) benefit from any upside in a way that respects the creditor hierarchy.

4.5 The resolution authority should be able to exercise powers of conversion or commutation, subject to the safeguards set out in KA 5, without being required to identify every creditor or potential creditor or to provide notice to each one.

4.6 The powers should allow resolution actions to be taken effectively and in a way that binds unknown creditors where:

- (i) claims have not yet arisen;
- (ii) claims have arisen but have not yet been notified;
- (iii) claims have not yet been estimated; or
- (iv) the identity of policyholders, claimants or beneficiaries is not known (for example because cover has been written by third parties and the claim investigation has not progressed to the point whereby all relevant parties have been identified).

Portfolio Transfer (Key Attribute 3.2(vi) and 3.7(i))

4.7 Resolution authorities should have the power to transfer contracts of insurance and reinsurance, including the power to vary or reduce the value of those contracts transferred. Where the value of the contract of insurance or reinsurance is uncertain or requires considerable time to evaluate, the power should provide for a pre-agreed mechanism to adjust the value of the contract after the transfer has been effected.

4.8 Resolution authorities should have the power to transfer any reinsurance associated with the transferred policies without the consent of the reinsurer.

Power to suspend insurance policyholders' surrender rights

4.9 In order to achieve an effective resolution, the power of the resolution authority to suspend creditor rights in resolution should extend to the ability to temporarily restrict or suspend the rights of insurance policyholders to withdraw from or change their insurance contracts with an insurer. The exercise of the power and duration of the stay should be appropriate to the nature of the insurance product (for example, the distinction between life and non-life insurance).

4.10 The resolution authority should have the power to stay rights of reinsurers of the firm to terminate coverage for periods relating to, or policies incepting, after the commencement of resolution. The resolution authority should also have the power to stay any right to no longer reinstate reinsurance cover upon payment of a premium; however, that power should be accompanied by an arbitration or compensation mechanism to determine a fair value of reinsurance premium to be paid in relation to the continued period of reinsurance coverage.

5. Safeguards

Respect of creditor hierarchy and creditor status of policyholders

5.1 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.

Pari-passu principle

5.2 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 resolution, subject to the “no creditor worse off safeguard” (Key Attribute 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).

No creditor worse off safeguard

5.3 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.

5.4 Authorities should clarify ex ante the method and as-of date by which claims in foreign currencies would be converted into the reporting currency of the failed entity.

6. Funding resolution

6.1 Jurisdictions should have in place privately-financed policyholder protection schemes that can assist in:

- (i) securing continuity of insurance coverage and payments by the transfer of insurance policies to a bridge insurer or third party or use of any other resolution powers; and
- (ii) compensating policyholders or beneficiaries for their losses in the event of a wind-up or liquidation.

7. Cross-border effectiveness

7.1 Where contracts are written under a governing law other than that of the jurisdiction where the insurer is located, authorities should be satisfied that the terms of transfer and liability restructuring conducted by the resolution authority will be effective, for example by including recognition clauses in the insurance contracts.

8. Crisis Management Groups (CMGs) and Cooperation Agreements (COAGs)

8.1 Crisis Management Groups (CMGs) and institution-specific cooperation agreements (COAGs) should be maintained or developed at least for G-SIIs. They should build upon existing supervisory colleges and cooperation agreements.

9. Resolvability assessments

9.1 All insurers that could be systemically significant or critical upon failure in a domestic or cross-border context, at a minimum all global systemically important insurers (G-SIIs), should be subject to regular resolvability assessments that are conducted in accordance with Key Attribute 10 and Annex II.

9.2 In undertaking a resolvability assessment to evaluate the feasibility and credibility of implementing the resolution strategy and operational resolution plan developed for the insurer, resolution authorities, in coordination with other relevant authorities, should assess in particular whether the chosen resolution strategy ensures the continuity of critical functions, including the continuity of coverage and payment for critical insurance contracts, and can be implemented without severe systemic disruption and without exposing taxpayers to loss.

9.3 The assessment of the feasibility of the resolution strategy should cover as appropriate:

- (i) the likely availability of a transferee or purchaser for any insurance business that is to be sold as part of the resolution strategy, taking into consideration the ability to use a bridge institution to operate the business on a temporary basis;

- (ii) the time needed to evaluate policyholder liabilities and the assets supporting, backing or to be transferred as consideration for assuming the liabilities, and for a potential buyer to carry out due diligence;
- (iii) the capacity of the policyholder protection scheme to fund its share of any transfer where there are insufficient assets to resolve all insurance liabilities in a timely manner;
- (iv) if the resolution strategy consists of or includes a solvent run-off, the risk that policyholders with later maturing policies may not receive their benefits in full and are 'time-subordinated' to those with earlier-maturing policies and short-term non-policyholder creditors;
- (v) the quality of management information systems and the documentation of insurance contracts, including the capacity of the firm to deliver detailed, accurate and timely information about the types of insurance business it undertakes, the number and type of policyholders, the benefits due to each policyholder, the reinsurance in place and information about assets, especially assets backing the insurance liabilities;
- (vi) the extent to which corporate structures and business units are aligned with legal entities to ensure that the sale, transfer or wind down of different business units can be accomplished through control of a single corporation or closely related group of corporations;
- (vii) the extent to which corporate capital structures would permit a bail-in within resolution in accordance with Key Attributes 3.5 and 3.6;
- (viii) the legal, operational and financial separateness of traditional insurance business from non-traditional insurance and non-insurance business;
- (ix) intercompany service agreements to ensure continuity of services;
- (x) the effect of intra-group transactions (for example, reinsurance transactions, loans or letters of credit, collateral upgrades or other liquidity support provided to banking entities, guarantees or letters of support, cost sharing or profit and loss-sharing agreements among affiliates) in resolution;
- (xi) the extent to which any interconnections or interdependencies between group entities or with third-parties affect the implementation of the resolution strategy;
- (xii) how contractual termination events (including cross-default) in financial contracts with insurers are defined, including whether rating down-grades, restructuring or (solvent or insolvent) run-off, in particular if occurring in a single legal entity within an insurance group, could trigger early termination of contracts of the relevant legal entity or its affiliates; and
- (xiii) whether surplus assets in other jurisdiction may be ring fenced in resolution.

9.4 When assessing the credibility and overall impact of implementing the resolution strategy, consideration should be given to its effects on third parties and financial stability as a whole, including whether the resolution of the insurer would cause:

- (i) a material adverse impact on economic activity as a result of any disruption to continuity of insurance cover and payment, which will be greatest when insurance is a pre-requisite to day-to-day economic activity (for example, employers' liability, trade credit and transport liability insurance); where a disruption in insurance claims and benefit payments is likely to cause significant and widespread financial hardship to households and businesses; or where the insurer has a significant share of the market;
- (ii) a lack of confidence in other insurers triggering a policyholder run, particularly where other insurers provide insurance that resembles on-demand savings products;
- (iii) an adverse impact on the resolvability of insurance or other financial operations undertaken elsewhere in the group;
- (iv) large investment losses for other financial institutions that could affect their capital resources;
- (v) the termination of securities lending and reverse repo operations that could affect funding and liquidity for other parts of the financial system; and
- (vi) an amplification of financial market disruption owing to the termination of financial guarantees or credit default swaps.

10. Recovery and resolution planning

10.1 All insurers that could be systemically significant or critical upon failure, at a minimum all G-SIIs, should be subject to a requirement for an ongoing process of recovery and resolution planning.

10.2 Recovery and resolution plans (RRPs) need to be tailored to the specific risks and systemic implications that each insurer may be exposed to or create and take into account the types of business the insurer engages in, its derivatives booking, intercompany guarantees, inter-affiliate support arrangements, risk pooling, shared services and risk management model and the nature of its assets and liabilities.

10.3 A key component of RRPs is a strategic analysis that identifies the firm's essential and systemically important functions and sets out the key steps to maintaining them in both recovery and resolution scenarios. Elements of such analysis should include identification of essential and systemically important functions, mapped to the legal entities in which they are conducted. Such essential functions could include, but are not limited to:

- (i) the provision of critical types of insurance policies, the continuity of which is a priority in resolution for reasons of policyholder protection or financial stability;
- (ii) the provision of services (actuarial, claims handling, policy administration, benefit payment, etc.) that are necessary for the continuation of the critical insurance business;
- (iii) essential hedging activities that are necessary to the continuation of the insurance business (for example, hedging for variable annuities with complex embedded options and guarantees, or hedging to closely match annuity cash flows);
- (iv) liquidity or other funding support provided to other financial institutions, the sudden withdrawal of which could have adverse effects on financial stability;
- (v) intra-group transactions, for example, reinsurance (including captive reinsurance arrangements), funding, liquidity and intra-group support and guarantees, that are essential to the continuation of critical functions elsewhere in a group structure or that could otherwise significantly affect resolution or recovery if they are disrupted or suspended; and
- (vi) credit or financial guarantee insurance, or non-insurance (for example, CDS), the withdrawal of which could have adverse effects on financial stability or the broader economy.

Recovery plans

10.4 Recovery plans should be developed on the basis of severe stress scenarios that combine adverse systemic and idiosyncratic conditions. They need to take into account insurance specificities such as the longer pay-out duration and the liquidity profile of insurers.

10.5 The insurer's direct supervisory authority, the policyholder protection scheme and relevant resolution authorities should cooperate in the review of the insurer's recovery plan.

10.6 In the case of G-SIIs, the review of the recovery plan should be carried out within the insurer's CMG.

10.7 Firms should identify possible recovery measures and the necessary steps and time needed to implement such measures and assess the associated risks of implementation. The range of possible recovery measures could include:

- (i) actions to strengthen the capital situation, for example, recapitalisations after extraordinary losses, capital conservation measures such as suspension of dividends and payments of variable remuneration;

- (ii) triggering of contingent capital instruments;
- (iii) possible sales of subsidiaries, portfolios of insurance contracts, renewal rights and spin-off of business units;
- (iv) changes to the reinsurance programme;
- (v) changes to the investment strategy and hedging programme;
- (vi) changes to business mix, sales volumes and product designs, including options to close books of business to new underwriting;
- (vii) changes to underwriting and claims handling practices; and
- (viii) modifications to contract terms and conditions, the level of charges, fees and surrender payments, the amount and timing of any discretionary benefits and the operation of discretionary incentives to renew contracts (such as 'no-claims discounts' or contract renewals without new underwriting).

10.8 A firm in solvent run-off should have a scheme of operations plan that sets out how all liabilities to policyholders will be met in full as they fall due and should include, for example, details on how expenses can be reduced as business volumes fall.

Resolution strategies and plans

10.9 In the case of G-SIIs, the resolution strategies and plans should be developed within the insurer's CMG.

10.10 Resolution plans for insurers should contain the essential elements set out in Annex III and also include, as appropriate to the type of the insurer, the following:

- (i) identification of policyholders that protected by a policyholder protection scheme and policyholders that are not eligible for benefits from such schemes;
- (ii) the actuarial assumptions used for calculating insurance liabilities and an independent exit value actuarial valuation of the technical provisions (policyholder liabilities);
- (iii) review of asset quality and concentration issues;
- (iv) preparation of insurance portfolio transfers, including a determination of the acceptability of assets to be transferred to any insurer assuming liabilities in a portfolio transfer;
- (v) sources of funding, including those from a policyholder protection scheme;
- (vi) provision for continuity or an orderly winding down of any derivatives portfolio;
- (vii) details on the allocation of ceded reinsurance among the various legal entities and impact on the recovery levels;

- (viii) an estimate of the outcome for each class of policyholder upon winding up (the counter-factual to the resolution plan and the basis for 'no creditor worse off' considerations); and
- (ix) practical arrangements for ensuring continuity of coverage and payment under certain types of insurance policies.

11. Access to information and information sharing

11.1 In order to facilitate the implementation of resolution measures, insurers that could be systemically significant or critical upon failure, including all G-SIIs, should be required to maintain information systems and controls that can promptly produce, both in normal times and during resolution, the relevant data and information needed for the purposes of timely resolution planning and resolution, for example in particular, on the following:

- (i) insurance activities where continuity of coverage and payment need to be maintained in resolution;
- (ii) details of eligibility for protection under policyholder protection schemes and scope of protection for eligible policyholders; and
- (iii) deposit-like products and other financial products that could be prone to runs.