Anna Maria D'Hulster
Secretary General
The Geneva Association

Andres Portilla
Managing Director RegulatoryAffairs
Institute of International Finance

Svein Andresen
Secretary General
Financial Stability Board
c/o Bank for International Settlements
Centralbahnplatz 2
4002 Basel

10 December 2014

Re: FSB consultation on Recovery and Resolution Planning for Systemically Important Insurers: Guidance in Identification of Critical Functions and Critical Shared Services 16 October 2014

Dear Mr Andresen,

The Geneva Association and the Institute of International Finance (IIF) welcome the opportunity to comment on the Financial Stability Board's consultation on the Guidance on Identification of Critical Functions and Critical Shared Services for the Recovery and Resolution Planning for Systemically Important Insurers (the "Guidance"). We set out below our general observations and answers to the questions raised. In summary our key messages are as follows:

- Given that there are likley to be very few "critical functions" within insurers (if any) it is important that the assessment process is proportionate and administratively simple. We would therefore suggest a filter approach based on market share/substitutability and timing, assessed together, to narrow the focus for analysis;

- We believe that a definition of critical functions (before being subjected to the filter described above) should focus on activities that could have a material impact on *both* the financial system and the real economy, and should not be watered down so as to be overinclusive and,

- We view that the six categories proposed are too broad and appear to constitute a comprehensive summary of all insurance sector activities rather than of activities that could potentially affect financial stability.

I. General comments

The Geneva Association and the IIF have established a designated joint working group to discuss the various questions set forth in the Guidance. The working group represents 18 insurers, 7 North American insurers and 11 European insurers.

Before addressing the questions raised in the Guidance, we would like to provide some more general observations we feel of utmost importance as policymakers and supervisors consider the discussion of how to evaluate what is and what is not a critical function or shared service.

Our members are in full agreement that large, globally active insurers are duty bound to do all within their power to plan for extreme shocks to their business, how to survive these events and/or allow for an orderly transfer or wind down of the business with minimal loss to policyholders and impact on the system. Therefore, our comments should not be considered as a critique of efforts to improve resolution regimes and require enhanced recovery and resolution planning, but rather a refinement of the proposed definitions and use of the terms "critical function" and "critical shared services".

The inability to find suitable and timely substitutes for a disrupted critical function has been identified as one means to create or aggravate systemic risk in the financial system. Thus, the perfomance of critical functions is considered to be one channel through which a financial institution could pose a risk to the system. For this reason we must take great care not to dilute the use of the term "critical" so that is becomes synonimous with the word "important". Effective resolution plans can and do take account of important activities, the role of the institution involved in the financial system, and appropriate resolution measures, all without having to commit to an overly broad category of "critical functions" and "critical shared services". To establish definitions for these terms that imply that any activity may be "critical", regardless of its link to the fundamental wiring of the financial system, is to suggest that virtually all commercial activity is potentially systemic in nature. We do not believe the Guidance seeks this result.

Our members are very concerned by what appears to be an altering of the scope of what critical functions are. Essentially, as we see it, to be "critical" a function or service must be so fundamental to the running of the financial system and the global economy that its disruption or withdrawal without the immediate availability of substitute functions or services would trigger a systemic event. The analysis in Section 2.2. of the Guidance appears to support this

understanding. However, it fails to take sufficiently into account several essential elements unique to insurers:

- Time is almost always a mitigating factor for a stressed insurer. Insurers do not fail overnight, but slowly, allowing actions to be taken for purposes of recovery and/or orderly wind down of the enterprise.
- Ready substitutes are almost always available. For the most part, insurers operate in highly competitive, un-concentrated markets, and offer highly standardized and substitutable products, and even where the activities in questions might under certain circumstance materially impact the financial markets, they may be small players in such activities in relevant markets.
- The examples of critical functions and products noted in the Annex inappropriately extend the potential scope of what may be a critical function beyond those activities that might be material to the financial system into areas covered by existing prudential regulation.

Narrowing our focus to the draft Guidance, we strongly suggest that a clarification of the scope and purpose of the draft Guidance on Identification of Critical Functions and Critical Shared Services would be valuable for reasons that follow.

First, we note that the consultation is directed towards national resolution authorities and their need to identify financial and economic functions for which continuity within the financial system is important. Therefore, identification of critical functions is mainly a supervisory tool for regulators in the context of development of resolution plans and the Guidance is not always clear on this point.

Second, the Guidance builds on the FSB's main document, Key Attributes of Effective Resolution Regimes for Financial Institutions, which is applicable to financial institutions that could be global *or* domestic systemically significant insurers. The Guidance itself, however, states that it "primarily focuses on those insurers which are identified by the FSB as global systemically important insurers (G-SIIs)".

Our response adopts the working assumption that the Guidance must refer to all firms operating in one domestic market because it aims at "ensuring an orderly resolution with reduced risks of systemic disruption and preservation of value" on domestic markets, but may seek to go beyond the context of a company's failure to elaborate on the broader macro-economic role of insurers. As we further narrow our focus and provide answers to specific questions, we would highlight that our comments are made without prejudice to our belief that there are likely to be very few critical functions within insurers (if any) and likewise few (if any) critical shared services.

II. GA/IIF response to the consultation questions

1. Are the definitions of "critical functions" and "critical shared services" appropriate for the insurance sector?

We welcome the fact that the FSB has acknowledged that insurers have features that are distinct from banks and has undertaken work with the IAIS to address the unique attributes of insurance. Among these fundamental differences, insurance is funded by upfront premiums, giving insurers strong operating cash-flow without requiring significant amounts of short term or wholesale funding. Further, insurance firms' strong capital and liquidity positions, as well as sound reserving practices, enable them to act as stabilizers within the financial system. The Guidance should reflect these distinctions. However, the Geneva Association and the IIF consider that the proposed definition and suggested examples, are not appropriate for the insurance sector.

In particular, the definition under the framework for critical functions has two parts. The first part refers to the material impact on the financial system and real economy. The second part refers to a situation in which an insurer's sudden failure to provide a function might have a material impact on third parties, if there is no mechanism in place to ensure continuity and if insurance coverage is vital for third parties to carry out economic activity. The second part of the definition inappropriately extends the potential scope of what may be a critical funtion beyond those activities that might be material to the financial system into areas covered by existing prudential regulation.

Given that this Guidance relates to policy measures designed to address financial stability, it is important that the focus of the critical function assessment be clearly based on its ability to materially affect the financial system and the real economy. It should not include non-systemically risky functions. We therefore suggest deleting the second part of the definition.

2. Should critical functions be identified based on whether the disruptions of the activity would adversely impact the stability of the financial system or the functioning of the real economy, or both?

Critical functions should be identified based on whether the disruptions of the activity would adversely impact *both* the stability of the financial system *and* the real economy. This would be consistent with the definition of systemic risk and the approach used for banking organizations.

Given the limited probability for the existence of critical functions among an insurance firm's activities, the process should be adminstratively simple. Therefore, a filter should be applied based on market share/substitutability, and timing, assessed together, to allow for a more targeted cost efficient analysis. This analysis should also take into account any cover provided by insurance

guarantee schemes. In the identification process, potential critical functions must first pass through a filter of their impact on financial stability (necessary condition for identification), then an assessment of whether this impact may have consequences for the real economy. The March 2010 Geneva Association report proposes a systemic risk filter approach to assess insurance activities. This could be adapted to identify critical functions.[1] Market share/ substitutability and timing (functions whose sudden disruption have an immediate effect) are key criteria to assess whether an insurance activity could impact financial stability.

Critical functions should be firm-specific, as the impact of a disruption of the activity would largely depend on individual portfolios and the comparative magnitude of a firm's participation in an identified function in relation to the national market. It is broadly acknowledged that traditional insurance activities, which represent the great majority of an insurer's business operations, are not a source of systemic risk. Therefore, the number of identified critical functions for an individual insurer in a given market is quite likely to be zero or, if any, extremely few.

3. Is the methodology for identifying critical functions laid out in the paper appropriate for the insurance sector? If not, what aspects are missing or need to be changed?

The methodology for identifying critical functions creates a distractingly broad starting point including virtually all insurance activities and seems to rely disproportionately on the methodology used for banks. It is also designed on the assumption that an insurer could suddenly fail which we maintain is a rare event.

Insurers hold assets to back their liabilities and their characteristics do not give rise to sudden failure. Assets and capital already generally exist to meet current and future liabilities if and when they fall due. In the rare case of failure, run-offs and portfolio transfers are the standard means to wind-up operations in an orderly manner and the liabilities of insurers can be run-off over extended periods.. In the insurance sector, local regulatory frameworks often ensure the orderly resolution of an insurer (run off, portfolio transfer) and to protect the market from any requirements for rapid liquidation of these long-term assets. Often, authorities have the power to slow early redemptions/cancellations requiring significant return of assets. The FSB has acknowledged the importance of this power by including it within its "Key Attributes of Effective Resolution Regimes".

Regarding the substitutability assessment that forms part of the methodology, we agree that it is a fundamental pillar of the identification process of "critical functions" .

[1] The Geneva Association, Systemic Risk in Insurance – An analysis of insurance and financial stability, March 2010, p. 33ff.

The question "Are the pricing levels, attachment points, and terms and conditions provided by the failing firm available?" suggests that the failing firm's policy pricing and conditions are appropriate. However, failures have often been caused by poor management including the under-pricing or by policy conditions which could not be met. Furthermore, the question points to a granularity in the definition of the relevant market that is unwarrented. Therefore, the question is not appropriate for the substitutability assessment.

While consumer demand for insurance products is primarily local, it is often the case that internationally active insurers can and do supplement available offerings. Due to national law and market conditions the large majority of insurance products are designed for a particular national market (except for reinsurance products). But such products can be supplied by either local firms or by globally active firms that can readily access the market as new entrants. The generally robust capacity of competitors to meet the insurance needs of a jurisdiction ought to be given great weight in any discussoin of whether a given function might be critical.

4. Do the six broad categories of activities outlined below cover all relevant and potentially critical functions? What additional categories, if any should be added?

The Geneva Association and the IIF would disagree that all the categories of activity are relevant to a determination whether a function is critical and do not think that any additional categories should be added. Our comments follow.

When Section 2.2. of the Guidance is read with 2.1. and ensuing related discussion, including the Annex, there appears to be a broadening of scope that unduly extends the definition of a critical function, with the net effect of rendering any activity that involves maintaining individuals' ability to go to work and or purchase goods as potentially "critical" in a systemic sense. Discussions at Sections 3.2 and 3.3 are illustrative of this tendency. We do not think this can be the end goal of the Guidance.

Investment in and lending to the real economy

The category of "Investment in and lending to the real economy" appears to be focused on concerns that these fundamental insurane underwriting activities might trigger certain adverse results in two ways in the case of a failure: 1) fire sales of assets, and 2) the cessation of a firm to provide liquidity in the capital markets through purchases of debt. Neither of these concerns point to a critical function.

First, the likelihood of a fire sale of assets by an insurer is very low due to the characteristics of the insurance business model. Insurance firms are rarely exposed to illiquidity risk, as they are required to hold and match assets to cover their liabilities[2]. Even if matched assets are not immediately liquid, most of them can be turned into cash in the necessary timeframe to meet requirements, if needed.

Second, given that an insurer's role as an investor in and lender to the real economy is a function of underwriting insurance policies, it is not clear what outcome the FSB is seeking to achieve by classifying "investment in and lending to the real economy" as a "critical function". A failing insurer may not be able to continue investing whether the activity is called critical or not. Moreover, the relative lack of the interconnectedness between insurers and other financial institutions, including their very low levels of intra-financial investment,[3] mutes concerns that any consequences would be systemic. We maintain that risks related to asset and liability management are adequately addressed by existing prudential regulation (examples include Solvency II, Swiss Solvency Test and U.S. RBC). We would also note that a failure will not necessarily reduce this activity at all. The failure of an insurance company would not reduce the need for insurance in society, and therefore, other insurers would fill the supply gap and purchase assets to match the liabilities that they underwrite.

Pooling of risk, particularly reinsurance, as an economic function

As the Guidance already acknowledges, there is no evidence that the vertical interconnectedness arising from the reinsurance business contributes materially to a reinsurer being systemic. The reinsurance industry has proven a high resilience over the last 20 years, in spite of several major natural and man-made disasters (e.g. 9/11, Hurricane Katrina). Evidence proves that significant substitutability exists for reinsurance coverage among market participants so that, if a reinsurer fails, portfolios are usually sold to other reinsurers, thereby preserving the cover offered to insurers. In addition, case studies, which project a reinsurance failure, have demonstrated that such a failure would not lead to a systemic event[4].

[2] The Geneva Association Surrenders in the Life Insurance Industry and their Impact on Liquidity, August 2012, p.15.
[3] Cross industry analysis—28 G-SIBs vs. 28 Insurers—Comparison of systemic risk factors, John H. Fitzpatrick, Economist Conference, London, 12 February 2013, published by the Geneva Association.
[4] The Geneva Association Insurance and Resolution in Light of the Systemic Risk Debate, February 2012 p. 30 ff; ACPR study "Analyse du risque de contrepartie de la réassurance pour les assureurs français", April 2013.

5. Is the methodology for identifying critical shared services laid out in the paper appropriate for the insurance sector? If not, what aspects are missing or need to be changed?

We agree that the determination of critical shared services should follow the identification of critical functions (if any).

In additon, references in the Guidance to the limited time and resources in resolution seem to be inappropriately influenced by the experience of bank resolution, in which capital shortfalls can lead to liquidity stress and a bank ceasing to be viable. Insurance has a different funding model, in which an insurer will continue to receive income from contractual policy premiums, even when closed to new business. Therefore, the issue of liquidity and having adequate resources to continue to provide shared services in resolution is less of a risk.

6. Is the framework flexible enough to cover the different types of business undertaken by G-SIIs? Are the non-prescriptives lists of examples of functions that could be critical helpful?

The framework is flexible enough. However, individual G-SIIs are very unlikely to provide activities to third parties where failure would lead to the disruption of services that are vital for global financial stability and the real economy.

7. Is the framework flexible enough to take account of the external environment in which failure is occuring, for example, an idiosyncratic event or a broader situation of more severe distress in the financial system?

Given that the intention of the Guidance is to provide a tool for supervisors to understand what are or are not critical functions, it is our opinion that the function of the activity within the financial system should define the scope of the framework. Whether the sudden disruption of the function is due to some issue within the Financial Institution or its stress as a result of external shocks seems less relevant than whether the disruption is the disruption of a "critical function", that is to say, a function that is fundamental to the financial system and the real economy. Having said that, we believe that the proposed framework, as modified and re-focused as we suggest in this comment letter, would be more than flexible enough to identify all critical functions in any environment, whether characterized by idiosyncratic or broad stress factors.

8. Are there any other issues in relation to the identification of critical functions and critical shared services that it would be helpful for the FSB to clarify in further guidance?

Although the identification of critical functions is important, it must nevertheless be acknowledged that, regardless of how well-managed and regulated the insurance industry is, any individual insurer can fail. While such a failure is unfortunate in many regards, the exit of weaker

insurers through failure is a natural occurrence in market based economies. Such failures can also contribute to a strengthening of the industry as a whole and improve its ability to protect policyholders. Equally, insurers may exit the market for reasons other than failure, e.g. due to changes in corporate structure,[5] mergers and acquisitions and general industry consolidation.

We hope these comments are useful as the FSB considers the way forward in this area. Given the complexity of these issues, we believe direct dialogue with the industry is essential. The Geneva Association and the IIF stand ready to provide additional views or clarifications.

Should you have any questions on the issues raised in this letter, please contact Anna Maria D'Hulster (annamaria_dhulster@genevaassociation.org), Andres Portilla (aportilla@iif.com), Kathrin Hoppe (kathrin_hoppe@genevaassociation.org) or Felipe Valdez (fvaldez@iif.com).

Yours sincerely,

Anna Maria D'Hulster

Andres Portilla

CC: Simonetta Iannotti, Eva Huepkes

[5] The Geneva Association, Insurance and Resolution in Light of the Systemic Risk Debate, February 2012, page 15ff.