



Institute
and Faculty
of Actuaries

Assessment Methodology for the Key Attributes of Effective Resolution Regimes for Financial Institutions

Financial Stability Board

Consultative Document

31 October 2013

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



Secretariat to the Financial Stability
Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

31 October 2013

Dear Secretariat

Assessment Methodology for the Key Attributes of Effective Resolution Regimes for Financial Institutions

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Consultative Document (CD) 'Assessment Methodology of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions'.

Actuaries undertake important roles within the insurance industry and their expertise is critical to the development and successful implementation of good risk management practices, which reduce the probability of insurers failing. This response has been prepared by the IFoA's Resolution and Recovery Working Party whose members have experience of, and expertise in, the insurance industry.

The IFoA is supportive of the FSB in setting out its assessment methodology for effective resolution regimes for financial institutions. However, there are a number of important points detailed below for the FSB's consideration. This response takes each of the Key Attributes (KA) and the supporting Essential Criteria (EC) in turn, focusing on questions 1 & 2; question 3 is explicitly addressed in reference to KA4.

Scope Resolution Authority and powers (KA1- KA3)

The IFoA agrees with the approach set out in KA1- KA3.

Set-off, netting, collateralisation, segregation of client assets (KA4)

One additional area that could be covered is third-party service providers who are outside the failed group as firms providing policy administration cannot easily be replaced at short notice.

The circumstances of the temporary suspension of termination rights in KA 4.3 only happen if contractual obligations are not met. In response to question 3, the IFoA acknowledges that whilst it is only given as an example, it could be that a limit of 'two days' would be too short to be of practical use.

London Staple Inn Hall · High Holborn · London · WC1V 7QJ · **Tel:** +44 (0) 20 7632 2100 · **Fax:** +44 (0) 20 7632 2111

Edinburgh Maclaurin House · 18 Dublin Street · Edinburgh · EH1 3PP · **Tel:** +44 (0) 131 240 1300 · **Fax:** +44 (0) 131 240 1313

Oxford Napier House · 4 Worcester Street · Oxford · OX1 2AW · **Tel:** +44 (0) 1865 268 200 · **Fax:** +44 (0) 1865 268 211

Hong Kong 2202 Tower Two · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +11 (0) 852 2147 9418 · **Fax:** +11 (0) 852 2147 2497

Safeguards (KA5)

The IFoA is supportive of the objective of having a range of potential funding options available. In particular, restricting the use of public funds to a temporary period prior to their recovery either from the firm or the industry will limit the costs borne by governments.

The recovery of temporary funding is linked to the principle that creditors should be no worse off than under liquidation. This suggests that some form of liquidation analysis will need to be carried out in parallel to the re-structuring. An insurance company has many different types of creditor, some of whom may be subordinated to others. Depending on local company law, it may well be the case that insurance policyholders rank *pari passu* with other creditors in a resolution scenario, including any pension scheme for employees and former employees of the company. This raises several important issues which the IFoA suggests it would be helpful to address in the paper.

Firstly, what each creditor would get on the liquidation of an insurance company as the 'default' process would depend on many factors and may be difficult to ascertain in advance of that happening. This in turn would make it difficult to determine what alternative arrangements to put in place. An analysis of the potential outcome for policyholders under the relevant local liquidation regime compared to an alternative resolution mechanism will have to be judged on a case-by-case basis and will involve both a subjective and an objective assessment. For example, in the UK, the scheme of arrangement procedure is generally favoured over liquidation for insurance insolvencies. In the liquidation process a number of rules will impact policyholder payouts (e.g. claims are forcibly calculated and paid in GBP; investment options are restricted in relation to cash balances held by the liquidator; and rigid reporting requirements). However, a liquidator is given unique powers to investigate and to apply to the Courts to overturn some pre-liquidation transactions. Such powers may generate additional recoveries for policyholders and creditors, which could outweigh the disadvantages of the liquidation process itself.

Secondly, the source of funds which might enable the provision of compensation would need to be determined. At least in principle a framework would be helpful to understand the relative roles of bail-in, any compensation scheme, or other sources of funding.

Thirdly, the respective roles of the different regulatory authorities in each country would need to be balanced. In the UK, for example, there could be conflicts between the Prudential Regulation Authority as the prudential regulator, the Financial Conduct Authority, from a conduct of business perspective and the Pensions Regulator in respect of any staff pension scheme which may be impacted.

In addition, as noted in the IFoA's response to the FSB's Consultation 'Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions', the regulators would need to recognise that they are unlikely to have all the necessary experience and expertise in house at all times, so there needs to be a mechanism whereby an advisory group can be convened at short notice. This requires advance thinking about the criteria for such a group given the public interest priorities and the need to acknowledge and manage conflicts of interest. With this advance thinking in place, it will be easier for the regulators to have the courage and confidence to act.

Funding of firms in resolution (KA6)

The Key Attributes for funding of firms in resolution appear reasonable, in particular, where they are aimed at avoiding the need for public ownership or funding to be the default options.

The IFoA would note that KA6.2. advises that the recovery of temporary funding from shareholders and unsecured creditors is subject to the principle of "no creditor worse off than in liquidation" and would therefore require a liquidation assessment to be carried out.

KA 6.3 supports the existence of deposit insurance, or resolution funds, or a mechanism for ex post recovery from the industry of the costs of temporary funding. The IFoA supports this approach but notes that in practice jurisdictions will need to make sure there is an appropriate balance between ensuring funds are available to support recovery and holding excess funds which act as an additional cost on the industry and which may be detrimental to policyholders from a different perspective. The IFoA would also note that where the issues are systemic across the industry the jurisdiction will need to consider what is an appropriate timeframe to recover the temporary funding. Making this too short may result in an undesirable consequential contagion.

Cross-border co-operation (KA7/9)

The IFoA agrees with the approach set out in these KAs. In particular, the IFoA supports the fair treatment across different jurisdictions, the avoidance of discrimination, the support of information sharing, and allowing either the home authority to take action over overseas branches or a host country to take action.

Crisis Management Groups (CMGs) (KA8)

The IFoA notes it will be challenging to bring together jurisdictions responsible for the CMGs of the nine current GSII's and identify (and ultimately resolve) the challenges they encounter. The IFoA is encouraged to hear that the US and UK authorities are making progress on a joint understanding.

The term "equivalent arrangement" does not appear to be defined. The IFoA believes the term is intended to capture the need to involve relevant authorities in resolution planning when a formal CMG is not a requirement (for example, when the jurisdiction is not host or home to a G-SIFI). The EC could benefit from being clearer as to when an equivalent arrangement would be required and what would constitute an appropriate equivalent arrangement.

The IFoA suggests the EC for KA 8.2 should set out in terms how the effectiveness of a jurisdiction's involvement in the CMG would be assessed. It would be helpful to be clear on who has what responsibilities and processes to resolve conflicts of opinion. A well-worded EC here could help authorities overcome some of the practical challenges of operating in a multinational environment.

Resolvability assessments (KA10)

There is a specific EC to ensure that recovery and resolution plans ("RRPs") are suitably informed by the findings of resolvability assessments (EC11.3.1). However, there is no equivalent EC for resolvability assessments to take into consideration the resolution strategies which make up the resolution plan. The IFoA believes that resolvability assessments need to assess the credibility of resolution strategies which feature in the RRP. The two are naturally intertwined, yet there is no reference to the RRP in the EC for resolvability assessments. The resolvability assessment is potentially an important step in the design and validation of the resolution plan in the RRP.

For KA10.5 it would be helpful for firms to know the circumstances under which a supervisory authority could require changes to its business practices, as opposed to having plans to change them should circumstances deteriorate. It is conceivable that a firm's business plans give rise to processes which could increase systemic risk in extreme conditions, but otherwise, are beneficial to the insurance market and economy. It may be possible to construct controls such that early warning indicators could be devised enabling necessary measures to be implemented sufficiently quickly to mitigate most of the systemic risk.

Recovery and resolution planning (KA11)

While the IFoA acknowledges that it is not always easy to define the key features of an economy's "financial stability" being impacted, more guidance could be given to supervisory authorities. This

could be assessed so that there is some consistency in how different countries determine which home firms should be designated. In addition, the IFoA suggests that there should be a materiality test applied rather than it relating to any impact on financial stability.

In EC11.4.1 the IFoA suggests that there could be an explicit reference to the Board of each entity. The FSB's Essential Elements of Recovery and Resolution Plans state that there is a need for responsibility for the plan and the associated governance processes to rest with senior management up to and including the Board. It would be useful to reiterate here the responsibilities of the Board.

The IFoA believes that aiming to make "the resolution of any firm feasible without severe disruption and without exposing taxpayers to loss" is too high a target given the wide range of circumstances and scenarios that could occur. The IFoA considers that this could be amended to aim to cover losses only in respect of any firm designated as a GSII or DSII (as in other KAs); and then not to cover all circumstances, as otherwise the capital requirements would be unsustainable.

The EC for KA11.9 do not include an assessment of whether a host authority should maintain resolution plans for firms in their jurisdictions. Therefore, it appears that it is a discretionary requirement for host, or indeed key host authorities, to maintain their own resolution plans. If this is not the intent summary wording may be necessary to clarify expectations.

The EC for KA11.10 covers the criteria for when an RRP should be reviewed and updated. As written, these cover changes in the firm's structure or operations, its strategy, or aggregated risk exposure. The EC could also account for the fact that there may be a critical need to amend the RRP in the advent of a material change in an external factor, (i.e. regulatory changes which impact the resolution mechanism). Also, arguably, some "Black Swan" events that are external to the firm may not immediately show up in the firm's aggregated risk exposures but could be important to how recovery is approached. These events could include changes in market normality, new trends in customer behaviour, and/or developments in market-impacting technologies.

Information Sharing (KA 12)

KA 12.2 requires firms to maintain Management Information Systems. It would be useful here to remind regulators to be mindful of the costs for producing additional information and to ensure that their requirements are proportional. Within a European context Solvency II will already require a substantial increase in disclosures to regulators and the IFoA would hope that this will meet the requirements in this area.

Should you want to discuss any of the points raised in greater detail please contact Paul Shelley, Policy Manager (paul.shelley@actuaries.org.uk/ 07917604985) in the first instance.

Yours sincerely



Nick Dexter
Chair, Recovery and Resolution Working Party