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Institute and Faculty of Actuaries

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HM Treasury

Introducing an Insurer Resolution Regime

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide and oversee their education at all stages of qualification and development throughout their careers.

Key points

The IFoA welcomes the opportunity to respond to the HMT's Consultation Paper *Introducing an Insurer Resolution Regime* and we support HMT's aims for such a regime.

We have considered HMT's proposals from an independent, public interest perspective; we note that HMT's aims for the regime are very relevant to the wider public interest.

The IFoA fully supports the government's intent to implement an Insurer Resolution Regime. We also support the introduction of a single RA, but we believe it will be important that the RA liaises closely with the PRA and FCA. In particular, in connection with ongoing Recovery and Resolution planning exercises, it will be important to co-ordinate the PRA's recovery and exit planning and the RA's Resolution Planning.

We understand that it is not easy to fit the Society of Lloyd's into the same regime as other insurers in view of its idiosyncratic structure. However, in our view, it is important that a compatible and consistent framework exists to cater for resolution scenarios involving Lloyd's.

There are number of types of entity which are not currently covered by the proposals or for which the position may be unclear to us. We believe that it would be appropriate for HMT to consider and provide clarity where appropriate to the resolution scenarios.

It would be good to define clearly what 'critical functions' are, as a weakness in the past has been the lack of a common understanding of what this term was meant to cover. A challenge is always going to be the assessment of 'likely to fail'. We note that this is an area where recent legal developments have arisen with regards to when a firm should be considered to be of 'doubtful solvency', which may be relevant here. We also note that the circumstances of an insurer failing may have different implications for it to re-capitalise.

We agree with the ancillary powers proposed. One additional power which could however be considered is to be able to provide liquidity/ credit to an insurer.

We believe that UK insurers should generally be familiar with the principles of the proposed regime. Therefore a relatively short lead-in time (for example, one year) could be feasible for most firms.

The IFoA would be happy to support HM Treasury in the development of the new regime and to participate in an advisory panel.

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1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the HM Treasury's Consultation Paper *Introducing an Insurer Resolution Regime*. We support HMT's aims for an insurer resolution regime, including the preservation of UK financial stability and ongoing policyholder security, maintenance of public confidence in the UK insurance sector, and promotion of effective competition in the insurance market.

2. In developing our response to the Call for Evidence, we have drawn largely upon input from a range of our members who have provided corresponding input on earlier international consultation papers on the development of an insurance resolution regime. The relevant range of members have experience in both life and general insurance.

3. It is important to note that, as for any IFoA response, we have considered HMT's proposals from an independent, public interest perspective. In doing so we have taken a broad perspective on the public interest; we note that HMT's aims for the regime - set out in the consultation paper - are very relevant to the wider public interest.

4. We hope that HMT find our response useful and we would be delighted to discuss it with HMT in due course.

Question 1: To what extent do you support the government's intent to implement the relevant international standards in the proposed regime?

5. The IFoA fully supports the government's intent to implement an Insurer Resolution Regime.

Question 2: To what extent do you support the introduction of a single Resolution Authority under the proposed regime?

6. We support the introduction of a single Resolution Authority (RA). However, as the RA is not to be the Prudential Regulation Authority (PRA) and given the significant involvement of the PRA and Financial Conduct Authority (FCA) in insurance regulation, we believe it will be important that the RA liaises closely with the PRA and FCA. The RA should take a consistent and coordinated approach as much as possible which would save effort by the regulators and reduce the burden on insurers. In particular, in connection with ongoing Recovery and Resolution planning exercises, it will be important to co-ordinate the PRA's recovery and exit planning and the RA's Resolution Planning (as mentioned in paragraph A.84).

7. A further key point to raise is that it is unclear to us how the RA proposes to interact with the Board of an insurer in circumstances where the Resolution Conditions have been met.

Question 3: Do you agree with the proposed scope of the regime?

8. The IFoA understands that it is not easy to fit the Society of Lloyd's into the same regime as other insurers in view of its idiosyncratic structure. However, in our view, it is important that a compatible and consistent framework exists to cater for resolution scenarios involving Lloyd's. This point recognises the size, complexity and underwriting nature (directly and as a material reinsurer) of statutory UK classes of business (e.g. motor, employer's liability, nuclear, equine etc). Given this, a resolution scenario involving the Lloyd's market could have widespread knock-on disruptive implications in the UK and overseas.

9. We believe that there should be some analysis undertaken over how resolution activities involving groups which operate in Lloyd's and also have insurance company subsidiaries would result in comparable outcomes for Lloyd's and non-Lloyd's policyholders.

10. There are number of types of entity which are not currently covered by the proposals or on which the position may be unclear to us. We believe that it would be appropriate for HMT to consider and provide clarity regarding the approach to resolution scenarios affecting the following; note that some of these are not insurers, and others are insurers located outside the UK where overseas regulators and jurisdictions may be involved:

- certain small insurers which write important although limited lines of business such as trade credit insurers, surety and other financial guarantee insurers;
- pension superfunds;
- medical defence organisations;
- Gibraltarian insurers underwriting business in the UK and who are not required to hold assets onshore;
- offshore insurers (e.g. in respect of After The Event [ATE] business) who provide capacity to issuers operating in the UK as an appointed representative.

Question 4: Do you agree with the proposed approach for entry into resolution (i.e. the resolution conditions), including that this is not set at a fixed level of Solvency Capital Requirement/ Minimum Capital Requirement breach?

11. The IFoA agrees that it would be good to define clearly what ‘critical functions’ are, as a weakness in the past has been the lack of a common understanding of what this term was meant to cover. It is also helpful that the intention is to refresh this in light of evolution in the insurance industry and how it operates.

12. While we believe that a flexible approach will be required in applying the Resolution Conditions (RCs), we also think that it will be important for there to be some minimum fixed criteria (akin perhaps to the Pillar 1 and Pillar 2 solvency regime). In addition, in our opinion, explicit reference to the criteria including a firm’s capability to provide reliable financial and operational data will be important.

13. We agree with the proposed approach to RCs. A challenge is always going to be the assessment of ‘likely to fail’. The failing or likely to fail test is a Threshold Condition set out in the Financial Services and Markets Act (FSMA). Clarity on exactly how this assessment interacts with Solvency II’s Ladder of Intervention provisions and the rectification period firms found not to be in compliance with Solvency Capital Requirements/ Minimum Capital Requirements have would be helpful. We note further that the assessment of ‘likely to fail’ is an area where recent legal developments have arisen with regards to when a firm should be considered to be of ‘doubtful solvency’, which may be relevant here.

14. We note in paragraph 2.19 that the RA would be obliged to appoint an independent valuer and that it may be appropriate for an explicit reference to be made to an actuary being engaged as a central part of such a process. Appointment of valuers should place explicit responsibilities upon them regarding management of their own, and their employers’, past and future conflicts of interest with any other services that may be sought in resolution of the firm.

15. The IFoA believes that it will be important for guidance to be developed for such a valuation, in particular, the basis upon which it should be performed. While an objective test may be desirable, this may cut across the existing directors’ reasonable subjective assessment of the position of the firm. Such differences of opinion may result in material differences, including resulting in a firm that the directors reasonably consider not to be ‘likely to fail’ being considered insolvent when objectively assessed by an independent valuer. We note that certain liabilities may crystallise or materially increase once a firm finds itself in need of resolution activities.

16. We also believe that it will be important for guidance to be developed for such a valuation, for example how to allow for uncertainty that there is likely to be in various aspects of the valuation.

17. In addition, this guidance should also cover the determination of the capital requirements (paragraph A.20) and the projected balance sheets (paragraph A.29) to ensure these are prepared on a consistent and coherent basis; we have commented below in our response to Question 8 on the need for principles on how the No Creditor Worse Off (NCWO) independent valuation is made, and again this should be consistent.

18. Finally, it would be helpful for companies to have more information on how the PRA and RA will consider and apply the Threshold Conditions in practice, and in particular what scenarios might be considered to be a breach of them.

Question 5: Do you agree it is not appropriate for the bail-in stabilisation option to include the introduction of MREL or bail-in bonds for insurers?

19. The IFoA agrees that it is not appropriate for the bail-in stabilisation option to include the introduction of Minimum Requirement for Own Funds and Eligible Liabilities (MREL) or bail-in bonds for insurers for the reasons given in paragraph A.50.

Question 6: Do you support the proposed role of the FSCS in protecting certain policyholders under the bail-in stabilisation option?

20. We support the proposed role of the Financial Services Compensation Scheme (FSCS). However, in our view more detail is required here; for example, how bail-in might be applied to regular premium policies. If future premiums are reduced then there is an impact on FSCS top-up payments, but if they are not reduced then there is an impact on the incentive for policyholders to continue paying.

21. In addition, the situation is more complex for with-profits policies where the future benefits are not guaranteed and more time may be needed to establish an equitable treatment for these policyholders.

22. We note that there is recent experience of FSCS compensation being paid to non-life policyholders, but not for life policyholders where there may be tax consequences for the policyholders receiving payments from a non-insurance company, unless tax legislation is amended.

Question 7: Do you have views on how a firm's existing shareholders should be treated under the bail-in stabilisation option?

23. The IFoA notes that the circumstances of an insurer failing may have different implications for it to re-capitalise. If an insurer has been hit by an exceptional event but retains a viable franchise with good management, then investors may be willing to subscribe more share capital to take advantage of the inherent goodwill. It may be helpful to set out the framework within which firms may safely do this and the extent to which directors and senior management can be protected from shareholders and creditors while such arrangements are made. Such protections should, in our opinion, be time-limited.

24. Alternatively, where an insurer's failure has been due to bad management with no viable business strategy, then it is likely that it would be difficult to re-capitalise and existing shareholders would be largely wiped-out.

25. If the firm is insolvent (after taking account of any future costs that could arise as a result of the resolution), the existing shareholders should be wiped out. If the firm still has existing-shareholder capital (after future resolution costs), bearing in mind the Resolution Conditions (RCs) necessary for the insurer to be placed in resolution, the RA should attribute a much-reduced value to this existing capital compared with the additional capital being contributed by the new shareholders.

26. It may also be helpful to explain whether the intention is for the RA to take on the powers of shareholders during resolution, including with respect to appointment and removal of directors. Post-resolution, and depending upon the outcome of this resolution activities, the position of shareholders and creditors may then be clearer.

Question 8: Do you agree with the proposed scope of the NCWO safeguard and compensation, including the approach to calculating the counterfactual?

27. We note that the NCWO safeguard is framed as the minimum a policyholder should receive whereas the EU has used ‘not lose more than’ as its definition. The latter version avoids much uncertainty because it can be applied at the date of resolution. Whereas the former version requiring policyholders to receive at a minimum what they would have received in a liquidation seems to imply, for example, that the estate of an annuitant who dies unexpectedly a few days/ years after the resolution date could claim a right to the value that his/her annuity would have had if a liquidation had taken place then instead.

28. Given this is a new resolution regime, the IFoA believes that HM Treasury should specify principles to be applied in determining the level of NCWO compensation required, including on how the actuarial analysis should be undertaken and recognising that the circumstances of an insurer resolution may well be idiosyncratic. The IFoA would be willing to support HM Treasury in the development of the principles.

29. There are various challenges with applying the NCWO safeguard. For example:

- is the determination of NCWO calculated on the actual date resolution is triggered? There may be significant uncertainty at that date or determination could be at a later date when the uncertainty has diminished;
- it may be that it would make more sense to assess NCWO for a ‘group of similar policyholders’ rather than on an individual basis. For example, the valuation of annuities and life cover can vary significantly for an individual policyholder depending on what mortality assumptions are used and their granularity. Furthermore, with continuity of insurance, the eventual outcome for an individual policyholder can produce a value that is very different from a valuation made at any previous point in time (indeed they will seldom match);
- payments on with-profits policies could vary significantly depending on how it is assessed. Any surplus in the (previously) ring-fenced with profits fund is to be distributed;
- there is also an issue on how FSCS compensation might be determined for these policies.

30. One work-around over the impossibility of making predictions about who is, and who is not going to be worse off used for Part VII transfers is a formulation along the lines of ‘not expected to be materially worse off’. This would enable the RA to take a sensible view based on their assessment at the time so that they are not paralysed by the requirement. Consumer/ small SME policyholders will retain FSCS protections, so this could provide a pragmatic way forward.

Question 9: Considering the requirements of the Key Attributes, do you agree with the proposed approach to pre-resolution planning?

31. Paragraph 2.30 explains that the RA will be empowered to take enforcement action if a firm does not take the actions it is directed to take to remedy barriers to resolvability. More detail is required of what these enforcement powers are, but the IFoA notes the needs for these to be coordinated with any actions that may be being taken by the PRA.

Question 10: Considering the requirement of the Key Attributes, do you have views on how a restriction of policyholder surrender rights in resolution should be structured (including for example, the appropriate length of this restriction)?

32. We note that other policyholder options, such as pension transfers or fund switching, may need to be restricted.

33. On the question of an appropriate length for any restrictions, it is not straightforward to give a definite period for this. It is difficult to estimate ex-ante the period for which sufficient uncertainty over policy valuations, liquidity problems or administrative issues may endure. Our view is that such restrictions should be reviewed regularly and be removed as quickly as possible.

Question 11: To what extent will the proposed ancillary powers support an effective resolution? Are there any other issues to consider?

34. We agree with the ancillary powers proposed. One additional power which could however be considered is to be able to provide liquidity/ credit to an insurer (i.e. where it has cashflow difficulties that will make a solvency resolution worse than it needs to be).

Question 12: What lead-in time would be appropriate for industry to prepare for the proposed regime? Are there any elements of the proposed regime that would not require a lead-in time?

35. The IFoA believes that UK insurers should generally be familiar with the principles of the proposed regime. Therefore a relatively short lead-in time (for example, one year) could be feasible for most firms.

36. It may be that some of the provisions which do not require action by individual companies, such as those concerning the establishment of the RA, could be implemented sooner.

Question 13: Do you agree with the potential impacts of introducing an IRR identified in chapter 2? How would the proposed regime impact insurance firms' costs?

37. One issue we think should be considered is the potential for a resolution to lead to potential surpluses or deficits to arise over time. This is due to the scope for there being significant uncertainties over the run-off of liabilities and/ or the valuation of assets at the point resolution is triggered. It may be that the circumstances which have led to an insurer failing are not idiosyncratic and it is possible that other insurers may subsequently fail. In such circumstances it could be possible for any surpluses and deficits to be pooled so as to minimise any industry levies or individual insurer write-downs.

38. As noted in our answer to Question 2, we believe it will be important that the RA liaises with the PRA (and FCA), and have a consistent approach as much as possible, which would save regulatory effort and reduce the burden for insurers.

39. To avoid excessive compliance, and if not already established in other powers, there should be an overarching limit on the obligations on firms to act in a proportionate fashion given their nature, scale and complexity.

Question 14: Do you have any other comments on this proposal, or the government's approach to insurer resolution?

40. The proposals do not mention whether the RA has the power to charge any costs to the insurer for any services it or others, might provide; for example, the costs of the RA stepping in to act, and for any independent valuer it may need to appoint. We note that in resolution scenarios, the RA may be required to retain valuers at short notice and from a relatively small pool of non-conflicted individuals.

41. The IFoA would be happy to be represented on the advisory panel mentioned in paragraph A.115.

Should you want to discuss any of the points raised please contact me, Steven Graham, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham
On behalf of Institute and Faculty of Actuaries