BANK OF ENGLAND

UK response to the Commission consultation paper on a possible recovery and resolution framework for non-bank institutions: summary

1. The UK welcomes the Commission's paper on a possible recovery and resolution framework for financial institutions other than banks.

2. The recent financial crisis highlighted the significant impact that failure of systemically important financial institutions can have on financial stability, including the costs that tax payers can be exposed to in order to prevent disorderly failure and to protect the financial system and the wider economy. However, as the Commission's consultation paper notes, the sources and possible channels of contagion of systemic risk can vary significantly.

3. It is clear that non-bank financial institutions can be systemic. They can carry very significant financial exposures both to and from other market participants. And they can also provide functions and services that are critical to the successful operation of the wider financial system.

4. As such, we think it will be important to consider how appropriate mechanisms for containing the impact of their failure – including permanent resolution frameworks – can be designed and implemented.

5. Domestically, the UK Government published the consultation paper "Financial Sector Resolution: broadening the regime" in August 2012. This document also acknowledged that there are non-bank financial institutions and financial market infrastructures (FMIs) which could pose serious risks to both financial markets and the wider economy if there is no way for them to fail safely. The consultation set out a series of proposals and questions on enhancing the mechanisms available in the UK for dealing with the failure of these institutions.

6. Following the closure of the consultation on 24 September 2012, the UK Government introduced legislation through the Financial Services Act 2012 to establish a permanent resolution regime for UK Central Counterparties (CCPs) and also investment firms. We continue to consider the case for introducing domestic legislation in areas beyond this. We will consult further with the UK finance sector in due course. On investment firms, we are of course following the developments under the negotiations for the Recovery and Resolution Directive and are factoring these in as far as possible while taking forward our domestic regime.

7. The UK remains committed to implementing the Financial Stability Board's (FSB) recommendation[1] to put in place appropriate recovery and resolution regimes for

[1] Endorsed by G20 leaders at the Seoul Summit in November 2010

systemically important financial institutions[2] (SIFIs) and has already started taking steps in domestic legislation in this respect. As such, the UK agrees with the Commission that further work in this area should be set within this international context, as well as taking into account ongoing work being undertaken by other international organisations such as the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) who are currently considering how the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions ('Key Attributes') should be applied to FMI and insurers. This will serve to ensure that any action at the European level is internationally consistent and adequately reflects the cross-border nature of financial markets.

8. The content of our response is structured to outline our views and to share the evidence we have been able to gather during our domestic consultation. It also draws on our experience of designing and implementing the UK Special Resolution Regime.

9. We hope that the Commission will find this useful in shaping its views on any possible recovery and resolution regime it develops for non-bank institutions. Our position is briefly summarised below by broad sector groups. The attached annex provides more detailed responses to your questions. We are, of course, happy to discuss our domestic experience in more detail if that would be helpful.

Financial market infrastructures: Central Counterparties and Central Securities Depositories

10. The UK agrees that a special resolution framework should be developed for CCPs with further consideration being given to the need for special frameworks for other types of FMI. Any possible regime will need to allow for the different types of institution that fall within this category and their specific characteristics. And, given the international nature of many of these firms, it will be important that it operates in line with the FSB Key Attributes and the CPSS-IOSCO Principles for FMI and consultative report on recovery and resolution of FMI, as well as any further relevant work they may produce.

11. The UK has already begun implementing the Key Attributes by developing a CCP-specific resolution regime, as part of the Financial Services Bill. This regime is similar to that which we already have in place for the banking sector. Its main features include:

    - Transfer powers similar to the stabilisation powers available under the Banking Act 2009;
    - An enhanced power of direction for the Bank of England over UK CCPs; and
    - A power of direction over the administrator of a UK CCP.

12. The regime differs from our domestic banking sector resolution regime. As in banking sector resolution, we have retained the protection of financial stability as an objective of resolution. However, we have also included an additional objective of maintaining the continuity of critical services for CCPs – recognising the systemic consequences of critical services becoming unavailable in that context. We believe that this objective would likely be equally applicable to other FMI.

[2] Banks and non-banks (including insurers) and for FMI (including central counterparties, payment and settlement systems, central securities depositories) Trade repositories and exchanges and trading platforms may be systemically important but more work is required to determine the extent of the resolution arrangements that may be necessary for these firms.

13. In addition to the powers mentioned above, we believe that it might be necessary for the authorities to have a 'bail-in' type power to allocate losses to an FMIs creditors and members. However, we believe there are conflicts with European legislation, including FCAD and EMIR, which could constrain or prevent this power from being effective. We believe that it is important that the Commission review these conflicts and make the necessary amendments to any relevant regulations and directives.

14. Again, as in banking sector resolution, we have linked trigger conditions for resolution to the conditions for authorisation/recognition of a CCP. These conditions do not include ex ante tests of systemic impacts or the introduction of specific thresholds relating to the size of the entity (as the size of an FMI does not necessarily determine its criticality in the market). But our domestic legislation for CCPs also gives the Bank of England the power to intervene before a CCP would otherwise meet the conditions for resolution if that can be justified on grounds of financial stability. Clearly, in coming to any such conclusion, the Bank would need to take into account the risk of creating market uncertainty in already stressed circumstances.

15. Our domestic UK legislation also grants the Bank of England, as supervisor and resolution authority, a power of direction that enables it to direct the CCP on financial stability grounds (as part of its normal supervisory powers and therefore outside of a resolution) and the administrator of an insolvent FMI to ensure that their actions do not have adverse impacts on financial stability. We agree that the resolution of FMIs should observe the hierarchy of claims in insolvency to the extent possible and respect the principle that creditors should not be worse off than in insolvency.

16. Outside of resolution and as set out in the Key Attributes, we believe that FMIs should develop their own recovery plans which would be reviewed by the relevant supervisory authority. These should include the development of loss-allocation rules for inclusion in the rulebook of the FMI. In line with the CPSS-IOSCO Principles for FMI, a requirement for CCPs to have loss-allocation rules and recapitalisation arrangements should be in EU law or regulation. We expect to consult shortly on introducing a similar requirement within our domestic legislation. Similarly, resolution plans should be owned and developed by authorities, on the basis of the information provided by the firm. Unlike a CCP's high-level recovery arrangements, detailed resolution plans should not be publicly disclosed, although possible resolution strategies could be disclosed.

17. Domestic action focusing on CCPs to date does not mean that we have ruled out that other forms of FMI (for example, CSDs, trade repositories and exchanges could also be systemically important). But we believe that further analysis is necessary to determine the case for action in these areas. We will therefore be interested in better understanding the evidence that the Commission gathers through this consultation.

18. We believe that resolution powers over other group entities (including holding companies) should be available if it is not possible to effectively resolve the FMI on its own (e.g. because of linkages between group companies). For groups with entities in different jurisdictions, a group resolution plan should be agreed between different resolution authorities. The group resolution plan should not prevent a resolution authority from taking necessary action regardless of whether it has been agreed in the plan or not.

19. In terms of cross-border resolution, the domestic resolution authority should pull the trigger to place the entity into resolution and there should be consultation with the 'resolution'

college to the extent practicable. Existing colleges, including those set out in EMIR, are likely to need adaptation to allow for the possibility of inclusion of third country jurisdictions.

Insurance and reinsurance firms

20. The UK also welcomes the Commission's work on recovery and resolution frameworks for insurance. We believe that this is an important area of further work and look forward to working with the Commission in the future on options for a possible framework for insurers.

21. Consistent with the FSB Key Attributes, the UK has set out two overarching objectives for responding to insurer failure, specifically that: any insurer should be able to exit the market without disorderly impact; and an appropriate degree of policyholder protection should be achieved, including, where appropriate, through continuity of cover.

22. Traditional tools have been used in the UK to deal with the failure of small and medium sized insurance companies, and have generally proven adequate for this purpose. However, there has been no experience in the UK of resolving either a large life insurer, or a large complex insurance group with operations in numerous jurisdictions. In light of this, the UK authorities are currently undertaking work to assess the adequacy of traditional tools in such a scenario, notably in dealing with a rapid failure and securing continuity of cover for policy holders.

23. As part of this work assessing existing domestic arrangements, the UK authorities are also exploring what pre-insolvency actions may be appropriate to stabilise a systemically important insurer and thereby prevent it from entering a potentially disorderly insolvency.

24. The UK authorities agree that mechanisms to facilitate cross border communication and coordination, at least within the Union, would be desirable, insofar as they assist national resolution efforts, and we think there is scope to develop a framework for improved cooperation.

25. Whilst the UK is in principle supportive of developing common minimum tools and powers, as well as the strengthening of cross border cooperation, within the EU, we do not support the centralisation of responsibility for resolution at the European level.

Payment Systems, Payment Institutions and Electronic Money Institutions

26. We have not yet taken domestic legislation in this area but continue to consider the case for doing so and recognise the arguments, in particular, in favour of the introduction of special administration or resolution arrangements for payment systems. These firms are critical to the financial system and could cause widespread disruption if their service were discontinued under ordinary insolvency. Service-providers which underpin the functioning of payment systems should also be within the scope of the powers. Clearly, any legislation that the UK may take domestically would only capture payment systems within the UK's jurisdiction. We would hope that the Commission could also consider payment systems that operate beyond national boundaries.

27. The arguments for action appear far less strong in the case of payment institutions and electronic money institutions, but we would be interested in understanding any evidence the Commission may identify to the contrary through this consultation.

Conclusion

28. We look forward to working with the European Commission to make progress on this issue and to ensure that the risks to financial stability posed by the failure of non-bank financial institutions are minimised as far as possible. We would, of course, be happy to discuss and follow-up on specific points and to answer any questions the Commission may have on our experience with our domestic UK legislation.

Annex

UK response to the Commission consultation paper on a possible recovery and resolution framework for non-bank institutions: detailed response

Response to section 3: Financial market infrastructures

a) General:

1. Do you think that a framework of measures and powers for authorities to resolve CCPs and CSDs is needed at EU level or do you consider that ordinary insolvency law is sufficient?

- We agree that ordinary insolvency law is not sufficient to resolve a failing CCP whilst maintaining financial stability and other public policy objectives. Therefore a special resolution framework should be developed, in line with the Key Attributes. These state that jurisdictions should have in place resolution regimes that provide the resolution authority with a broad range of powers and options to resolve any financial institutions whose failure could have broader systemic consequences. This position is also consistent with the consultative report of the Committee on Payments and Settlement Systems and the International Organisation of Securities Commissions (CPSS-IOSCO[3]) which recognises the need for authorities to have a framework of powers available to resolve different types of FMIs.
- The UK has already begun implementing the Key Attributes by developing a CCP-specific resolution regime, as part of the Financial Services Bill. We support the Commission's intention to explore the suitability of ordinary insolvency law to resolve other FMI and whether resolution arrangements are also required for these institutions.

2. In your view, which scenarios/events might lead to the need to resolve respectively a CCP and a CSD? Which types of scenarios CCPs/CSDs and authorities need to be prepared for which may imply the need for recovery actions if not yet resolution?

- There are a variety of scenarios that could result in the failure of an FMI, including scenarios arising from the default of a member and those not involving the default of a member. Therefore the recovery planning of an FMI as well as the resolution framework that an FMI is subject to should enable recovery and/or resolution regardless of the cause of distress.
- We agree with the CPSS-IOSCO position that an FMI is best placed to analyse different circumstances that could impact its viability. FMIs should develop comprehensive, substantive plans that identify critical operations and services, develop strategies and measures necessary to ensure continued provision of critical operations and services, and

[3] http://www.bis.org/publ/cpss103.pdf

test their effectiveness against tailored scenarios that may prevent the FMI from being able to continue as a going concern.

- Although FMIs should test the effectiveness of their plans against tailored scenarios, their plans should be sufficiently flexible and adaptable to identify the different types of risks they are exposed to and consider how uncovered losses or other negative impacts would be addressed.

3. Do you think that existing rules which may impact CCPs/CSDs resolution (such as provisions on collateral or settlement finality) should be amended to facilitate the implementation of a resolution regime for CCPs/CSDs?

- Yes. Rules which might prevent or constrain the effective resolution of CCPs/CSDs should be amended where necessary, because these were put in place before resolution arrangements were envisaged. We set out below some examples and encourage the Commission to review existing provisions against proposed resolution measures.
- The Financial Collateral Arrangements Directive (FCAD) potentially presents impediments to the effective exercise of resolution powers.
- One of the aims of FCAD is to ensure posted collateral can be realised, and that close-out netting can take effect. In doing this, it prohibits member states from having statutory powers that delay, override or modify the enforcement of the terms of the financial collateral arrangement. Whilst we recognise the benefits of this protection, it also hampers the effective exercise of resolution powers with regard to its protection of close out netting rights.
- We note that such rights may be amended for banks being resolved under the RRD powers; where the RRD seeks to disapply FCAD, safeguards are built into the RRD itself. This should also be considered for FMIs.
- The FCAD also constrains the ability of authorities to haircut margin, which may be necessary to protect public funds from the costs of resolution (action taken in respect of a CCP and some CSDs) as discussed on pp. 20-21 of the consultation. (We believe FCAD does not constrain the ability of FMIs to have margin haircutting arrangements in their rulebooks.)
- Additionally, Article 45(4) of EMIR may create an impediment to certain forms of loss allocation (i.e. initial margin haircutting) as it prohibits the use by a CCP (and, potentially, by a resolution authority) of margin lodged by non-defaulting members to cover the losses from the default of a different member (assuming uncovered losses have occurred because of member default(s)). And Article 43(3) states that clearing members of a CCP shall have limited exposures to that CCP which may in some situations also be a constraint to allocating losses; though it does recognise that non-defaulting members may be required

to provide additional funds to the CCP in the event of the default of another clearing member.

- As these examples demonstrate, a careful review of the relevant Directives and Regulations is required to ensure that they do not prevent whatever loss allocation method that is adopted being able to be carried out.
- EMIR also sets out a process for authorisation of CCPs. As part of resolution, it may be necessary to transfer quickly part or all of a failing CCP's activities to another CCP or a bridge entity. This may require new authorisation/ permissions; this should be done on an expedited basis to ensure that resolution objectives can be achieved. Also see response to question 20 below. This should also take into consideration any authorisation requirements under CSD Regulations and other relevant legislation.
- Some CSDs in Europe extend credit and hold collateral in respect of their participants and so similar limitations may exist in legislation such as those mentioned above. Here also, we support the Commission looking to ensure that there are no similar conflicts that would prevent effective resolution of CSDs across Europe.

4. Do you consider that a common resolution framework applicable to CCPs and CSDs is desirable or do you favour specific regimes by type of FMIs?

- We do not have a strong preference as to whether there is a common framework or specific regime, but it is important that the required powers are available to authorities to deal with both types of FMI. It is of utmost importance that the powers available to authorities enable them to deal effectively with both types of FMI and are flexible enough to be adapted to the specifics of each institution and scenario. As noted above, the Key Attributes set out the broad stabilisation and liquidation options that should be available for resolving a failing institution, and the FSB's assessment methodology group are considering the extent to which any amendments need to be made for FMIs, with the assistance of CPSS-IOSCO. The Commission's proposals should be consistent with this.

5. Do you consider that it should only apply to those FMIs which attain specific thresholds in terms of size, level of interconnectedness and/or degree of substitutability, or to those FMIs that incur particular risks, such as credit and liquidity risks, or that it should apply to all? If the former, what are suitable thresholds in one or more of these respects beyond which FMIs are relevant from a resolution point of view? What would be an appropriate treatment of CSDs that do not incur credit and liquidity risks and those that incur such risks?

- We support resolution tools (including modified insolvency or administration procedures[4]) being available for all CCPs. We also support the Commission's intention to explore resolution tools for CSDs (including for those that do not take credit or liquidity risks).
- We do not support the introduction of an ex ante test of systemic impact as a condition for the applicability of resolution, for the following reasons. First, given their central role in the financial system, the majority of FMIs are likely to have systemic consequences in the event of their failure. Second, systemic importance is a dynamic concept, and a particular institution can be systemic depending on the circumstances at the time of distress. It will be difficult to determine how critical an infrastructure will be in advance of extreme situations. Therefore, the decision to place an institution into resolution or other arrangement should be taken by the resolution authority at the point of resolution, with the decision being dependent on prevailing circumstances at the time.
- We disagree with the introduction of thresholds as the size of an FMI does not necessarily determine its criticality in the market. Additionally, thresholds could incentivise FMIs to run their business in such a way that avoids meeting such thresholds.

6. Regarding FMIs (some CSDs and some CCPs) that are also credit institutions is the proposed bank recovery and resolution framework sufficient or should something in addition be considered? If so, what should the FMI-specific framework add to the bank recovery and resolution framework? How do you see the interaction between the resolution regime for banks and a specific regime for CCPs/CSDs?

- The authorities should have the flexibility regarding the resolution strategy of each institution, and be able to exercise a judgment-based approach in the application of the most suitable resolution tools.
- There are sufficient differences between FMIs and banks to warrant the development and application of an FMI specific recovery and resolution regime, as different tools (such as haircutting margin) and triggers for resolution may be required with regard to FMI.
- It is important to have clarity over which framework will apply to a failing entity, especially where two regimes could apply to a specific set of institution (e.g. FMIs with banking licences). This could be achieved by calibrating the scope of the different regimes to ensure there is no overlap for instance or by the resolution authority making clear ex ante which regime will apply in the event of their failure.
- We note that (I) CSDs which incur credit and liquidity risks are registered as credit institutions. The forthcoming CSD Regulation (CSDR) may require changes to the ICSDs' business models. If the outcome of the CSDR is ultimately a requirement for activities

[4] Under a modified insolvency regime the administrator would have a specific objective to ensure (at least temporary) continuity of service. The regime could be accompanied by an additional power to direct the insolvency practitioner to meet this primary objective.

bearing credit and liquidity risk to take place in a separate legal entity, then it seems natural that this entity should be within scope of the RRD. Alternatively, if the ICSDs are permitted to retain their current business models, then it will be important to have clarity over the legislation that applies to them. In particular, it is vital that these institutions do not fall between arrangements for resolving banks and bespoke arrangements for specific categories of FMI.

b) Objectives:

7. Do you agree that the general objective for the resolution of CCPs/CSDs should be continuity of critical services?

- Any potential resolution regime for FMIs, like that for banks, should comprise: a set of objectives; a toolkit; and supporting elements, notably creditor safeguards, to ensure that the framework is as effective and transparent as possible.
- Continuity of critical services is an important objective given the systemic consequences of critical services becoming unavailable, but it is a subset of the overarching objective to preserve financial stability. We define "continuity" here as meaning for the FMI to be able to continue to provide critical services to participants to the level and with the scope of the services it provided prior to entering recovery or resolution.
- All objectives (including those stated in the consultation) should be appropriately balanced.
- The objectives of the proposed UK regime for CCPs are: protect and enhance stability of UK financial systems, protect and enhance confidence in financial systems of the UK, maintain the continuity of CCP clearing services, protect public funds and avoid interfering with property rights. Those objectives are not prioritised. However, in many cases it is likely that the first three objectives may be best served through the continuity of the FMI's critical services.

8. Do you agree with the above objectives for the resolution of CCPs/CSDs?

- Some of the items described as 'operational objectives' would be better described as necessary components of a successful resolution framework, such as developing co-ordination mechanisms, rather than objectives of resolution itself. We would encourage the Commission to reconsider its description of objectives.

9. Which ones are, according to you, the ones that should be prioritized?

- The objectives should not be prioritised but should be balanced appropriately by the resolution authority on a case by case basis as noted under question 7.

10. What other objectives are important for CCP/CSD resolution?

- See response 7 and 8 above.
- In respect of CSDs, a potential additional objective could be to ensure that the settlement of existing instructions in the system continues to complete on time. This should include settlement of existing instructions in the system as the time of resolution (i.e. there should not be a moratorium on settlement here), as well as continuing settlement thereafter.

c) Recovery and Resolution plans:

11. What should be the respective roles of FMIs and authorities in the development and execution of recovery plans and resolution plans? Should resolution authorities have the power to request changes in the operation of FMIs in order to ensure resolvability?

- As set out in the Key Attributes, FMIs should develop their own recovery plans and they should be reviewed by the relevant supervisory authority. The supervisory authority should be able to request changes to the recovery plan. The supervisory authority should lead and consult with the resolution authority who if different could make recommendations to the supervisor.
- We support authorities assessing the resolvability of FMIs and having the power to request changes in the operation of FMIs to facilitate their resolvability. The resolution authority should lead the resolvability assessment, but as noted above the supervisor should lead on operational changes to facilitate resolvability.
- We also support resolution plans developed by authorities. But this should not limit an authority's ability to use measures not specified in the resolution plan if this is deemed necessary.

12. To what extent do you think that CCPs/CSDs in cooperation with their users would be able to define efficient recovery and resolution plans on the basis of amendments to their contractual laws?

- Recovery plans are owned and developed by the firm. To the extent they involve members/ other market participants, these should be agreed in advance for example through contracts or the institution's rule book. The same applies to any other parties involved (e.g. shareholders and other third parties). Amendments to contractual arrangements can be effective in ensuring continuity of critical services.
- Recovery planning should include clear and agreed arrangements on how the FMI will allocate any uncovered losses it may incur (in addition to the authorities being able to allocate losses in resolution). This is consistent with the CPSS-IOSCO Principles for FMIs (PFMI) which require that an FMI's 'rules and procedures should address how potentially

uncovered credit losses would be allocated. These rules and procedures should also indicate the FMI's process to replenish any financial resources that the FMI may employ during a stress event, so that the FMI can continue to operate in a safe and sound manner.' (Principle 4 Key Consideration 7).

- In line with the PFMI, a requirement for CCPs to have loss-allocation rules should be in EU law or regulation; EMIR and the associated technical standards do not tackle this issue and we think this is a regulatory gap which needs to be addressed. The UK would support the Commission's intention to explore CSDs being required to put in place appropriate loss allocation rules including plans to deal with any prospective capital shortfall.
- Resolution plans, on the other hand, are to be owned and developed by authorities, on the basis of the information provided by the firm. The details should not be publicly disclosed though high level resolution strategies could be put in the public domain. Hence modifications of contractual agreements are not relevant to the development of resolution plans.

d) Resolution triggers:

13. Should resolution be triggered when an FMI has reached a point of distress such that there are no realistic prospects of recovery over an appropriate timeframe, when all other intervention measures have been exhausted, and when winding up the institution under normal insolvency proceedings would risk causing financial instability?

- Broadly, we support this approach but it may not be the case that all other intervention measures have been exhausted. For example, if an FMI has exhausted only some of its recovery measures but has no realistic prospect of recovery (defined as an FMI being able to continue to provide critical services without interruption) or no realistic prospect of recovery without negative impacts on financial stability, the relevant authority should be able to place the FMI into resolution.
- Triggers could be explicitly linked to the conditions for authorisation/recognition of an FMI but there should not be an automatic trigger for resolution. Authorities should have sufficient discretion to decide on a case by case basis whether to put an FMI in resolution.

14. Should these conditions be refined for FMIs? For example, what would be suitable indicators that could be used for triggering resolution of different FMIs? How would these differ between FMIs?

- The trigger conditions are appropriate for all FMI.

15. Should there be a framework for authorities to intervene before an FMI meets the conditions for resolution when they could for example amend contractual arrangements and impose additional steps, for example require un-activated parts of recovery plans or contractual loss sharing arrangements to be put into action?

- Yes, supervisory authorities should have the power to intervene for financial stability reasons. For example, authorities may require the implementation of parts of recovery plans which have not yet been activated (including contractual loss allocation arrangements) or take other actions as necessary.
- But the authorities should also be aware of the risk of creating market uncertainty in already stressed circumstances, through an ability to amend contractual arrangements and take this into consideration if action is taken and should seek to avoid outcomes for market participants that are materially worse than in insolvency.

e) Resolution powers:

16. Should resolution authorities of FMIs have the above powers? Should they have further powers to successfully carry out resolution in relation to FMIs? Which ones?

- We would support having available the range of powers and tools set out in the Key Attributes and the CPSS-IOSCO consultative document on recovery and resolution of FMIs. The tools should include, where relevant, the transfer of securities, property, rights and liabilities of an FMI to other companies in the same group, a private sector purchaser or bridge entity controlled by the resolution authority.
- In order to protect public funds, resolution authorities should also have powers to haircut the claims of creditors, subject to appropriate safeguards as set out in the CPSS-IOSCO consultation. This may currently be constrained by other EU regulations such as FCAD and EMIR (see response to question 3). So it is important for the Commission to make any necessary amendments to ensure a resolution framework can be applied effectively.
- The Commission's paper mentions appointing an administrator, but not directing the administrator or setting particular objectives. There should be a power for the resolution authority to prevent the FMI entering insolvency if it is going to be taken into resolution (i.e. the court has to inform the resolution authority that an FMI may be placed into insolvency, and the resolution authority has a window within which it can then directly take the FMI into resolution). The resolution authority should also have a power to direct the administrator of an insolvent FMI for financial stability reasons (for example where an entity in administration is required to continue providing certain critical services or functions to a different part of the entity, which is being resolved by the authorities).
- On powers to temporarily stay the exercise of early termination rights and to impose a moratorium on payment flows we outline views under questions 18 and 19.

17. Should they be further adapted or specified to the needs of FMI resolution?

- As noted in answer to Q.4 above, the FSB is currently developing an assessment methodology for the Key Attributes, and this will take into account the specific nature of different types of financial institution including FMIs. We would encourage consistency with the assessment methodology.
- Notwithstanding the potential issues we raise under question 3, we would support the Commission looking into the feasibility of statutory powers that support loss allocation for both CCPs and CSDs.
- Euroclear UK & Ireland Ltd (EUI), the one CSD that operates in the UK, maintains the central record of dematerialised UK securities (electronic record of ownership of UK securities), this is a critical market function which should be taken into consideration in developing any possible CSD resolution regime.

18. Do you consider that temporary stay on the exercise of early termination rights could be a relevant tool for FMIs? Under what conditions? How should it apply between interoperated FMIs? How should it be articulated with similar powers to impose temporary stays in the bank resolution framework?

- We support the adoption of a temporary stay on the exercise of early termination rights that may otherwise be triggered upon entry of a firm into resolution or otherwise on the use of resolution powers, as this can assist the authorities in some circumstances in carrying out a resolution whilst minimising disruption to the financial system.
- The decision on whether to use such a power should ultimately be taken by reference to the resolution objectives, but also take into consideration disruption it could cause. We note that this position is in line with the CPSS-IOSCO consultation. Authorities should, in deciding whether to use a stay, take into account its market and other implications, including the safety and orderly operations of any FMI/regulated exchange. In practice it is likely that any disruption that might be caused by a stay could be outweighed by the disruption caused by a mass close out financial market contracts in the absence of a stay. To minimise disruption the stay should be used for the shortest time practicable and transparent to market participants. It should not apply to a situation where the FMI in resolution has failed to meet payment, deliveries and collateral transfers or obligations. And following expiry of the stay, close-out should be immediately possible for financial contracts left in an insolvency but not possible for financial contracts transferred to a solvent and complying third party or bridge institution. This is consistent with the Key Attributes.
- In terms of interoperating FMI we propose adopting the same approach as outlined above.

19. Do you consider that moratorium on payments could be a relevant tool for all FMIs or only some of them? If so, under what conditions?

- A moratorium could potentially be useful tool for all FMIs, but with different applications. It should not interfere with the ordinary flow of payments and deliveries being processed by a payment or settlement system as part of its core functions; for an FMI in resolution, the highest priority for the authorities is likely to be to preserve the continuity of the FMI's critical functions and minimise systemic disruption. A moratorium preventing outgoing payments would amplify systemic disruption, causing a build-up of exposures between participants in volatile market conditions; placing liquidity strains on some market participants; and causing general illiquidity in certain financial markets. Any moratorium should therefore only apply to payments made to general creditors by the FMI as principal.
- In the case of a CCP and certain other FMIs that engage in principal risk, payments are made to creditors as part of its ordinary business (e.g. variation margin payments) and there may be provisions within their own rules to pause or haircut those payments as part of default management or other arrangements.
- We believe that the power to impose a moratorium should only be used where no other options are available. The authorities should take into account the market impact and other points noted under question 18.
- Further analysis is required to consider the impact of a general creditor moratorium in this context, though the underlying objectives should remain as continuity of critical services and minimising disruption to the rest of the financial system.
- Consistent with the Key Attributes, a moratorium should not be imposed on payments between interoperating FMIs.

f) Resolution tools:

20. Which reorganisation tools could be appropriate for resolving different types and CSDs and CCPs? What would be their advantages and disadvantages?

- Transfer and reorganisation tools are an important part of resolution arrangements, and this is reflected in their inclusion in the proposed UK domestic powers for CCP resolution under the Financial Services Bill.
- Advantages include facilitating continuity of critical services (in turn giving confidence/ certainty to members and the market) and giving the authorities time to find longer-term solutions (e.g. finding a new owner) through the use of a bridge institution where no immediate alternative/substitute FMIs are available.
- The power to transfer all or part of the FMI's operations to one or more third parties, including another FMI or bridge institution, is an important one. It is wider in scope than

the power to transfer all or parts of the FMI's operations to a healthy market service provider (see page 19 of the Commission's consultation).

- In practice, there are often few (if any) substitutes/alternative service providers for a particular FMI. This may limit the number of transfer options available to authorities in resolution. Where an alternative provider exists, there could be practical issues that would prevent participants from being able to transfer their accounts, assets, positions and activities immediately. Safeguards such as protections on netting sets may restrict the ability of the authorities to 'break up' or otherwise reorganise firms such as CCPs.
- For CCPs, any new legal entity that acquires the FMI (existing CCP) will need to be authorised (temporarily until a full review has been completed) on an expedited basis in order to facilitate immediate transfer and therefore continuity – there will need to be a clear justification for this on financial stability grounds.
- Assuming the outcome of CSDR is similar to the authorisation requirements under EMIR, we would support the Commission considering the same approach as above (temporary recognition on an expedited basis of CSDs).

21. Which loss allocation and recapitalisation tools could be appropriate for resolving different types of CSDs and CCPs? Would this vary according to different types of possible failures (e.g. those caused by defaulting members, or those caused by operational risks)? What would be their advantages and disadvantages?

- An effective resolution regime should include appropriate tools to ensure that losses as far as possible do not fall on the public sector. The proposed UK FMI resolution regime does not currently include an equivalent of the bail-in tool for banks, largely due to the difficulties in designing a tool that would be compatible with existing EU legislation (such as FCAD, which currently prevents haircutting margin). We are keen to work with the Commission to address this situation as quickly as possible, to enable a loss allocation power to be added to the toolkit.
- We think that a clear distinction should be drawn between loss allocation (such as 'end-of-the-waterfall') arrangements in rules that FMIs and relevant parties may agree, reflecting the particular characteristic of many FMIs that they are rules-based entities; and any 'bail-in' applied by the authorities in resolution.
- Loss-allocation rules and recapitalisation arrangements should be set out in the rulebook of the FMI, consistent with the CPSS-IOSCO Principle 4 Key Consideration 7 (see response to question 12 above).
- However in the event that the FMI's rules prove inadequate to allocate losses, there should be additional powers available to the authorities to aid resolution of FMIs whilst protecting public funds. Any 'bail-in' applied by the authorities in resolution should seek to respect the creditor hierarchy in insolvency and have appropriate safeguards, should authorities need

to deviate from the creditor hierarchy on public interest and financial stability grounds in line with the FSB Key Attributes. This is consistent with the CPSS-IOSCO consultation paper (paragraph 3.20).

- However, the given the principle of 'No Creditor Worse Off' as set out the Key Attributes, the extent of loss allocation by authorities should be compared with the extent of losses in the counterfactual of ordinary insolvency. Where allocated losses exceed those suffered in ordinary insolvency, compensation may be applicable.
- Regarding CSDs, the type of loss allocation/ recapitalisation tools that could be adopted depend on the activities of the CSD. Resolution financing mechanisms designed by member states and cash calls upon members/participants could be considered as loss allocation tools. Additionally where CSDs hold collateral, haircuts could be applied.
- The CSDs membership structure should be taken into account when determining appropriate types of loss allocation arrangements, for example in some cases sponsors directly use the system and provide connectivity to a large number of underlying members. We would support the Commission looking into this further.

22. What other tools would be effective in a CCP/CSD resolution?

- It is important to be clear about the distinction between recovery actions that can be taken by a failing CCP or FMI, and resolution powers available to the authorities.
- Normal supervisory powers to direct an FMI should be extended to include a power to direct the FMI on financial stability grounds. This should include powers of direction over arrangements related to provisions to allocate losses and/or tear up contracts under the FMI's rulebook.
- If an FMI is placed into administration/ insolvency rather than resolution, a power of direction for the authorities over the administrator/ insolvency practitioner would be needed to ensure that their actions do not have adverse impacts on financial stability.
- It may be useful for a resolution authority to have a power to tear-up contracts cleared by a CCP in resolution, such that the settlement obligations or expiry dates of contracts are amended. In effect, the resolution authority could implement an immediate cash-settlement (an 'invoicing back' or 'tearing up') of open contracts where this assists the resolution process. Such amendment of contractual terms could be implemented across all cleared positions or just a subset of them.
- Any such action by the resolution authority must, of course, be in compliance with statutory requirements and take into account appropriate safeguards to protect netting sets, and consider the wider financial stability impact of taking, or not taking, such action. We believe that the proposed statutory powers and recovery tool described above for tear-up should not apply to CSDs, consistent with the additional objective of ensuring that

settlement continues to complete on time but we would support the Commission looking into this issue further.

23. Can resolution tools based on contractual arrangements be effective and compatible with existing national insolvency laws?

- In general terms, we note that recovery arrangements are contractual, and that resolution arrangements are statutory.
- If the focus of this question is intended to be rule-based tools (such as loss allocation arrangements), we consider that they should be effective under UK insolvency law. For example, existing UK law such as Part 7 of the Companies Act 1989 confers certain protections on the default rules of a clearing house should one of its members become insolvent. These are important protections.

g) Group resolution:

24. Do you consider that a resolution regime for FMIs should be applicable to the whole group the FMI is a part of? What specific tools or powers for the resolution authorities should be designed?

- In terms of FMIs that are part of the same group, coordination and planning, to the extent possible, are essential. For groups with entities in different jurisdictions, a group resolution plan should be agreed between different resolution authorities. Consistent with the Key Attributes, the group resolution plan should be based on the presumption of cooperation between authorities in different jurisdictions, but should not prevent a resolution authority from taking necessary action regardless of whether it has been agreed in the plan or not. Each FMI, as separate legal entities, will need their own resolution authority. Resolvability assessments can also be used to check the level of integration and outsourcing of an FMI. Where possible steps can be taken following such an assessment to ensure the FMI's level of integration and outsourcing arrangements will not create impediments in resolving the FMI.
- Resolution powers over other group entities (including holding companies) should be available to cover cases where it is not possible to effectively resolve the FMI on its own (e.g. because of linkages between group companies). Any barriers to resolving an FMI on its own should be identified and removed as part of the Recovery and Resolution Plan process.
- We agree with CPSS-IOSCO that resolution regimes should take links into account, including links between affiliated FMIs. We also agree with the FSB Key Attributes that authorities should have powers to ensure continuity of essential services and functions by requiring other companies in the same group to continue to provide essential services to the entity in resolution.

h) Cross border resolution:

25. In your view, what are the key elements and main challenges to take into account for the smooth resolution of an FMI operating cross-border? What aspects and effects of any divergent insolvency and resolution laws applicable to FMIs and their members are relevant here? Are particular measures needed in the case of interoperable CCPs or CSDs?

- We agree with the CPSS-IOSCO consultative report that a resolution authority should take into account the impact of a resolution on any linked/interconnected FMIs, regardless of whether they are located in the same jurisdiction or a different jurisdiction.
- Arrangements under CPSS-IOSCO's Responsibility E will help ensure cooperation among relevant authorities, consistency across recovery and resolution plans, facilitate communication, facilitate the recognition of resolution actions taken in other jurisdictions and improve transparency.
- We envisage cross-border coordination and cooperation that does not rely on college agreement for resolution to be triggered or actions to be taken because of the potential fiscal impact an FMI's failure could have on the jurisdiction in which it is established. Resolution authorities should be able to take decisions, where necessary, without the need to consult the college in advance.
- In terms of interoperable CCPs we envisage a similar approach, with much closer communication, and a degree of collaboration, between the relevant authorities.
- In terms of CSDs we would support the Commission considering similar approach, however coordination and cooperation will be even more important for CSDs where one CSD is linked to another as failure of one could cause the failure of the other.

26. Do you agree that, within the EU, resolution colleges should be involved in resolution issues of cross border FMIs?

- To be consistent with Article 80 of the Recovery and Resolution Directive, authorities should not establish resolution colleges if existing groups or colleges perform similar functions and carry out similar tasks. Existing groups or colleges may need to be adapted however to allow for the possibility of including relevant third country competent authorities. If required, the resolution authority for an FMI should be able to take decision and act without consulting the college first, in situations in which urgent action is required (consistent with Article 20(3) of EMIR).

27. How should the decision-making process be organized to make sure that swift decisions can be taken? Alternatively, do you think that responsibility for resolving FMIs should be centralised at EU-level?

- We do not support a centralised EU resolution body for the following reasons. First, national supervisory authorities are best placed to know the specifics of firms registered in their jurisdictions, the macroeconomic context and the interaction of the FMI with the key actors of the domestic and global market participants. Second, the potential use of taxpayer funds requires national authorities to be directly accountable for implementing a resolution. Third, the effective application of a resolution tools must be swift and minimally intrusive and would therefore best take place at the national level.
- Consistently with EMIR provision Article 20(3), resolution authorities should be able to make decisions, where required urgently, without the need to consult with members of the resolution college.

28. Do you agree that a recognition regime should be defined to enable mutual enforceability of resolution measures?

29. Do you agree that bilateral cooperation agreements should be signed with third countries?

- Cooperation arrangements should facilitate the recognition of resolution actions taken in other jurisdictions, there is therefore no need for a recognition regime. In Europe we would expect resolution actions to be enforceable and in respect of third countries there may be a need for a greater level of cooperation to support enforceability.
- Cooperation arrangements among all the relevant authorities, including third country authorities, will enhance cooperation and ensure that effective cross-border resolution is possible. However, responsibility for drawing up and entering cooperation agreements should remain with Member States.

i) Safeguards:

30. Do you agree that the resolution of FMIs should observe the hierarchy of claims in insolvency to the extent possible and respect the principle that creditors should not be worse off than in insolvency?

- We agree. Consistent with the CPSS-IOSCO consultation on FMI recovery and resolution, the starting point at which further losses are imposed in resolution should be based on claims as they exist following the FMI's ex ante rules and procedures for addressing uncovered credit and liquidity needs and the replenishment of financial resources. To the extent possible, the foreseeable outcome of the operation of national insolvency law could also be considered, as a counterfactual.
- We think that it is of paramount importance to achieve consistency with the relevant provisions in the Recovery and Resolution Directive.

- However, the given the principle of 'No Creditor Worse Off' as set out the Key Attributes, the extent of loss allocation by authorities should be compared with the extent of losses in the counterfactual of ordinary insolvency. Where allocated losses exceed those suffered in ordinary insolvency, compensation may be applicable.

Response to section 4: Insurance and reinsurance firms

Traditional tools used in the UK for dealing with failed or failing insurers

The UK does not have a resolution regime for insurance companies. In the UK, traditional methods whereby failed insurers exit the market include run-off, voluntary[5] portfolio transfers, restructuring of liabilities (scheme of arrangement), and insurance-specific insolvency procedures including modified administration and winding-up. Alternatively an insurer may voluntarily put its entire business up for sale.

The UK has an insurance guarantee scheme, which is one part of the UK's Financial Services Compensation Scheme (FSCS). It currently compensates eligible[6] policyholders for up to 90% of the value of their policy for non-compulsory insurance and 100% for compulsory insurance. This is triggered when an insurance firm is judged unable (or likely to be unable) to pay claims falling due; and this is a decision made by the FSCS, not by the regulator. The FSCS can also use its funds to assist insurers in financial difficulties, and to facilitate continuity of cover via business transfers or the issuance of replacement contracts. It can pay benefits falling due as per its compensation policy (90% for non compulsory policies) whilst it is seeking continuity of cover.

There are no arrangements in place to establish a bridge institution. We note that the bridge institution is included by the EC as a 'traditional' insurance resolution tool which is available in some member states, but that it has also been included by the FSB as a tool appropriate to the resolution of systemically important firms.

The UK welcomes the European Commission's work on recovery and resolution frameworks for insurance, and believes that this is an important area of further work. In August 2012, HM Treasury published a consultation that sought views on whether improvements are required to the current UK insolvency framework for insurers and whether a comprehensive resolution regime with stabilisation powers, as is currently available for banks, is also required for systemically important insurers. Following responses from industry stakeholders to the consultation, the UK authorities are currently engaged in work to assess what reforms may best strengthen domestic arrangements, including whether improvements are required to the current insolvency framework for insurers and whether a comprehensive resolution regime with stabilisation powers is also required. We look forward to working with the Commission on options for a possible recovery and resolution framework for insurers.

1. **Are the resolution tools applicable to traditional insurance considered above adequate? Should their articulation and application be further specified and harmonised at EU-level?**
2. **Do you think that a further framework of measures and powers for authorities, additional to those already applicable to insurers, to resolve systemically relevant insurance companies is needed at EU level?**

[5] The UK regulator cannot compel an insurer to transfer a portfolio of insurance business to a third party.

[6] Only retail customers and small businesses are usually eligible claimants for general insurance. For life and compulsory insurance, the list of eligible claimants is wider.

Adequacy of traditional tools

Traditional tools have been used in the UK to deal with the failure of small and medium sized insurance companies (almost exclusively general insurers), and have generally proven adequate for this purpose. However, there has been no experience in the UK of resolving either a large life insurer, or a large complex insurance group with operations in numerous jurisdictions. In light of this, the UK authorities are currently undertaking work to assess the adequacy of traditional tools in such a scenario.

Run-off

A common response by supervisors for dealing with a distressed insurance company is to withdraw the firm's permissions to write new business and place the outstanding business into solvent run-off, and in some cases this may be appropriate. However, this approach does leave policyholders exposed to a risk that the firm may become insolvent before all of the long-term policyholders have been paid out[7]. As a consequence, some firms that have entered solvent run-off may seek either to transfer their policyholder liabilities to another insurer, or terminate them early via private agreements to write-down the claims of policyholders and creditors.

Sale of whole business, voluntary portfolio transfers and liability restructuring

As mentioned above, distressed firms in run-off may voluntarily seek to extinguish their liabilities by a sale of the entire business, transferring them in whole or part using a portfolio transfer, or entering into a court-led agreement with creditors to terminate the liability in exchange for the payment of a lump sum.

These transactions tend to take months or years to conclude even in benign conditions, and would be difficult to achieve before insolvency in the event that a firm's financial condition deteriorates rapidly. The size and complexity of the failed firm, and the uncertainty over the value of the firm's business, could add further complications:

- The firm could be required to seek additional capital support, but experience suggests that in many cases it may prove difficult to find a willing provider of capital or a suitable buyer to take over the entire business;
- A portfolio transfer may be attempted but could be subject to protracted due diligence. In the UK an insurer can, with regulatory approval, transfer policies without the consent of the policyholders. Such transfers are voluntary in the sense that they require the approval of both the transferee and the transferor, with the regulator having no power to compel a firm to transfer its business. However, a partial transfer of only the more 'saleable' parts of the business may leave the remaining business in a worse position. It would bear the costs of the transfer and, due to the loss of diversification, may be unviable. A voluntary transfer is likely to only take place if it improves shareholder value; financial stability and policyholder protection concerns are unlikely to be prioritised by the firm.

[7] The risk of eventual insolvency for run-off firms is exacerbated by the firm's fixed costs being spread over a decreasing number of policies as time goes on and by the very significant difficulty for firms in run-off of raising fresh capital.

- A **Scheme of Arrangement** (a flexible court-based creditor agreement which can, amongst other uses, be used to terminate or restructure insurance liabilities) could prove difficult to arrange where there are many and diffuse creditors and policyholders, or where different books of business need to be split up. This could lead to a protracted process, with the potential for any creditor class to block the scheme even if all the others agree.

This suggests that, where an insurer failure is either particularly rapid, or concerns a large or complex firm, there is scope to strengthen the current framework. The UK authorities are currently undertaking work to explore the adequacy of traditional tools, including exploring what pre-insolvency actions may be appropriate to stabilise a systemically important insurer and thereby prevent it from entering a potentially disorderly insolvency.

Insurance insolvency procedures / Insurance Guarantee Scheme

Insurance insolvencies are typically long and costly. The insolvency practitioner (IP)'s objectives are not aligned with the financial regulator's objectives or with wider public interest objectives of maintaining financial stability and protecting policyholders. So the IP may take actions that conflict with these.

Insolvency procedures can be modified to require the IP to carry on long term business with a view to selling it on to a third party. However, where policyholders are not fully protected by the insurance guarantee scheme a full valuation of an insolvent insurer's assets and liabilities will be required, which will be a difficult and lengthy process that usually results in disruption to benefit payments. Long payment delays would have a serious effect on certain classes of policyholder such as pensioners whose annuities are relied upon as the main source of retirement income.

Further, the ability to provide continuity is dependent on the remaining insurers in the market having appetite to receive a transfer of business or to issue a block of new contracts to the failed firm's policyholders. For a large insurer, separate transfers would likely have to be agreed with a number of different purchasers. In practice it is likely that continuity would not be straightforward or quick to achieve.

In the UK when long term policies are transferred or replaced the insurance guarantee scheme (FSCS) is only required to secure at least 90% of the original contractual benefit. It seems likely that writing down the value of the accrued benefits for transferred policyholders to 90% would be very difficult. It will take time to calculate this amount and make the necessary systems modifications for it to be paid, which would prolong the period in which policyholders would have to continue paying premiums at 100%, despite being uncertain about the value of their policies.

An important factor to take into consideration is the lack of a common approach to insurance guarantee schemes across the EU/ EEA. This was highlighted in the report by EIOPA on the role of insurance guarantee schemes in the winding up procedures of insolvent undertakings in the EU/ EEA, published in July 2012. The report emphasised how many jurisdictions provide little or no insurance cover to policyholders, as well as an inconsistent approach in terms of the ability

to transfer a portfolio, the lack of a pre-warning system when insurers are in difficulty and the role of the supervisory authority when insurers become insolvent[8].

Insolvency may have additional unwanted consequences for firms engaged in any non-traditional insurance activities. For example, since entry into insolvency would be an event of default, there may be a disorderly close out by the failed insurer's counterparties of its derivatives positions.

Further Resolution Powers and Tools

The FSB Key Attributes of Effective Resolution Regimes for Financial Institutions set out the resolution powers that should be available in order to resolve any systemically important institution, including insurance companies. The IAIS have stated that the FSB requirements are relevant for G-SIIs, whilst noting that insurance specificities need to be taken into account in implementing them.

Along with other G20 members, the UK has signed up to the FSB's Key Attributes. So where firms are systemically important, the applicable resolution arrangements should meet the appropriate standards.

The UK is also considering whether there may be large and complex, though not systemic, insurance companies for which existing 'traditional tools' would prove inadequate. However, we are yet to reach any firm conclusions on the issue and believe this is an important area of further work.

Harmonisation

The UK supports the principle of minimum harmonised resolution tools to respond to the risks posed by systemically important insurers, and believes that the EC has a significant opportunity to improve cross-border resolution for insurers by ensuring that the FSB KAs are implemented in a consistent way across Europe. The Recovery and Resolution Directive for credit institutions and investment firms shows that minimum harmonisation at the EU level is possible and desirable. Greater harmonisation of existing traditional tools for resolving failed insurers would be practically difficult. For example, where existing traditional tools are court-based procedures, this could create complications when attempting to harmonise due to differences in legal frameworks across the EU.

3. In your view, which scenarios/events might lead to the need to resolve a systemically relevant insurance company? Even before that, which types of scenarios systemic insurers and authorities need to be prepared for which may imply the need for recovery actions if not yet resolution?

[8] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/Report_on_the_Role_of_Insurance_Guarantee_Schemes_in_the_Winding-Up_Procedures_of_Insolvent_Undertakings_in_the_EU-EEA.pdf

The UK's view is that the scenarios and events which could cause systemically relevant insurance companies to fail are likely to be many and diverse, reflecting the diversity of activities, business models and risks within the insurance sector. In particular any non-traditional, non-insurance activities undertaken by systemically important insurers may give rise to additional risks and hence additional sources of failure than those to which 'traditional' insurers are exposed.

The regulatory authorities support the undertaking of stress testing and reverse stress testing exercises, and on-going improvements to both supervisors' and firms' understanding of potential stress scenarios and the responses that would be available in those stress scenarios. The regulatory authorities also support the concept that insurers be expected to develop, as a matter of routine and as part of its ORSA once Solvency II comes into effect, planned recovery actions in response to stress scenarios – and provide to the regulator all information needed to perform an assessment of their resolvability.

However, it is unlikely to be possible or even desirable to try to predict or enumerate the full range of potential sources of failure. Further, it will be those events/scenarios which are hardest to foresee (and hence anticipate) that are most likely to lead to failure.

As such we believe that when designing an effective resolution regime for insurers we should be concerned with trying to mitigate the impact of failure *however it has arisen*, through the use of a flexible range of tools that are not overly tailored to respond to a narrow range of future circumstances. We believe this is more likely to lead to a stronger regime that can cope with a variety of different scenarios. Maintaining an acceptable probability of failure is at the heart of prudential supervision. The UK does not operate a zero-failure regime and nor will Solvency II. Our starting point is that firms in the future will fail, and that we need to be able to deal with that failure – however it has come about – in an orderly way. Orderly failure is desirable as it helps to maintain market discipline.

4. Do you agree with the above objectives for resolution of systemic insurance companies? What other objectives could be relevant?

The UK, along with other G20 members, has signed up to the objectives of resolution as set out in the FSB Key Attributes. The KAs provide appropriately for insurance by making reference to policyholder protection. Consistent with the FSB Key Attributes, the UK has set out two overarching objectives for responding to insurer failure, specifically that: any insurer should be able to exit the market without disorderly impact; and an appropriate degree of policyholder protection should be achieved, including, where appropriate, though continuity of cover.

5. Do you think that recovery plans should be developed by systemic insurers and resolution plans by resolution authorities? Do you think that resolution authorities should have the power to request changes in the operation of insurers in order to ensure resolvability?

The Prudential Regulation Authority (PRA) will expect all insurers to set out credible steps to maintain or restore their business to a stable and sustainable condition in the event of stress.

As the PRA's approach to insurance supervision paper[9] suggests, insurers should provide to the PRA all information needed to perform an assessment of their resolvability. This will also include ensuring the FSCS and insolvency practitioners have sufficient understanding of insurers' systems that they can undertake their functions effectively including maintaining payments to, and cover for, policyholders in the event of an insolvency, should that be needed.

Recovery and resolution plans

The UK regulatory authorities will consider whether and how to introduce domestic regulatory rules requiring insurers to have Recovery and Resolution Plans, with regard to the requirements of the FSB Key Attributes in this area.

Barriers to resolvability

The PRA's key expectations in regard to barriers to resolvability are summarised below.

- Where significant barriers to resolvability are identified, the PRA will expect insurers to propose and implement adequate changes to reduce these where possible.
- The less resolvable an insurer, the greater the degree of supervisory focus that will be applied to its plan for stressed scenarios and the actions implied by the firm's proximity to failure (as set out in the PRA's Proactive Intervention Framework, akin to the Solvency II Ladder of Intervention).

The UK encourages the Commission to consider implementing a similar approach.

6. Do you agree that resolution should be triggered when a systemic insurer has reached a point of distress such that there are no realistic prospects of recovery over an appropriate timeframe, when all other intervention measures have been exhausted, and when winding up the institution under normal insolvency proceedings would risk causing financial instability?

7. Should these conditions be refined? For example, what would be suitable indicators that could be used for triggering resolution of systemic insurers?

The UK considers that an insurer is 'viable' if it able to meet its threshold conditions for authorisation on an on-going basis. The threshold conditions are the minimum requirements that firms must meet at all times in order to be permitted to carry on the regulated activities in which they engage.

The UK agrees that resolution should be triggered if the insurer is no longer viable, or likely to be no longer viable, and the supervisor makes a judgement that there is no other solution that would restore the institution to viability within an appropriate timeframe. In addition, the use of

[9] http://www.fsa.gov.uk/static/pubs/other/pra-approach-insurance.pdf

resolution tools should be justified with reference to the objectives of resolution and the inability of insolvency proceedings to deliver those objectives.

8. Do you agree that resolution authorities of insurers could have the above powers? Should they have further powers to successfully carry out resolution in relation to systemic insurers? Which ones?

9. Should they be further adapted or specified to the specificities of insurance resolution?

10. Would the tools mentioned above be appropriate for the resolution of systemic insurers? What other tools should be considered and why?

The UK has signed up to the FSB Key Attributes, and as such where firms are systemically important, the applicable resolution arrangements should meet the appropriate standards.

The UK supports the work of the IAIS to determine in more detail which of the powers set out in the FSB KAs may require modification and/or additional guidance in order to be applied to insurers. In particular, we believe the triggers and safeguards applied to any resolution powers for insurers would need careful design to ensure they reflect the insurance business model, capital structure and legal structure, and the way in which insurance firms fail.

11. Do you think that, within the EU, resolution colleges should be set up and involved in resolution issues of cross border insurance groups?

12. How could the decision-making process be organized to make sure that swift decisions can be taken? Should this be aligned with the procedures already set out in Title III of Directive 2009/138/EC?

13. Alternatively, do you think that responsibility for resolving systemic insurers should be centralised at EU-level?

14. Do you think that a recognition regime should be defined to enable mutual enforceability of resolution measures?

15. Do you think that to this end bilateral cooperation agreements could also be signed with third countries?

The UK authorities agree that mechanisms to facilitate cross border communication and coordination, at least within the Union, would be desirable, insofar as they assist national resolution efforts, and we think there is scope to develop a framework for improved cooperation.

A group approach to recovery and resolution will need to take into account the particularities of each group's structure and the division between the responsibilities of host and home national authorities. This will require enhanced cooperation between national authorities.

The UK authorities do not have a firm view on the appropriateness and merits of setting up resolution colleges, but if such colleges were to be established we would need to avoid

duplication or the creation of potential gaps with supervisory colleges. These will need to have a clear focus on resolution and the potential to have a wider membership than simply the resolution authorities plus a subset of the supervisory college members (e.g. insurance guarantee schemes and finance ministries could be included).

Aligning the general procedure to be followed with Title III of Directive 2009/138/EC would, in principle, have advantages in that it would harmonise the co-operation and decision-making processes between supervision (under Solvency II) and resolution. However, decisions taken during resolution may have fiscal implications and support for financial institutions ultimately rests with national fiscal authorities and taxpayers. Further, it seems unlikely to fully harmonise the decision-making process for cross-border groups which include third countries.

Although the UK is in principle supportive of harmonisation of the tools and powers available for insurance resolution within the EU, and also supports the strengthening of cross-border co-operation via colleges and crisis management groups, we do not believe that centralisation of responsibility for resolution at EU level is a feasible solution:

- National supervisory authorities are best placed to know the specifics of firms registered in their jurisdictions, the macroeconomic context and the interaction of the insurers with the key actors of the domestic and global market participants;
- The potential use of taxpayer funds requires national authorities to be directly accountable for implementing a resolution;
- The effective application of resolution tools must be swift and minimally intrusive and would therefore best take place at the national level;
- Consistently with EMIR provision Article 20(3), resolution authorities should be able to make decisions, where required urgently, without the need to consult with members of the resolution college.

Additionally, there are significant differences in the insolvency regimes and insurance guarantee schemes across countries, which would impede any centrally-coordinated resolution.

The UK view is that recognition regimes and co-operation agreements at least within the Union will have a role to play in ensuring that cross-border resolutions can be carried out in an orderly way.

Bilateral cooperation agreements between the relevant authorities of third countries could set out how national legal and resolution regimes would interact. These agreements could complement institution-specific cooperation agreements among home and all key host jurisdictions, consistent with the requirements of the FSB's KAs for systemic financial institutions.

Response to section 5: Payment systems and other non-bank financial institutions

1. Do you agree with the above assessment regarding payment systems, payment institutions and electronic money institutions? Alternatively, do you consider that either (or both) would merit further consideration as to their ability, first, to give rise to systemic risk and, second, the need for possible recovery and resolution arrangements in response?

- We do not agree with the assessment that payment systems do not merit further consideration. 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'. This absolutely includes payment systems, which are critical to the financial system and so appropriate recovery and resolution arrangements should be put in place. This view is also supported by CPSS IOSCO.
- Regarding payment institutions and electronic money institutions, these firms are not generally considered to be currently of systemic important. But other public policy objectives, as well as potential future developments, should be taken into account when considering whether ordinary insolvency procedures are appropriate for such types of financial institution.

2. Besides those covered in previous sections of this paper, which other nonbank financial institutions can become systemically relevant and how? Depending on the type of institutions, what are the main channels through which such systemic risks are transmitted or amplified?

- Service-providers which are ancillary to the functioning of FMIs should also be in scope. In the UK, for example, the operation of payment systems often involves both a 'management company' that sets the rules etc; and a 'service-provider' entity that supplies and operates the technology. The latter is sometimes the central bank itself, but other service-providers should be within the scope of resolution framework.
- Other FMIs (for example, trade repositories and exchanges) and investment funds may be systemically important but more work is required to determine whether special administration or resolution arrangements are necessary for these firms. It is important to ensure that the interaction with ongoing legislative initiatives (e.g. amendments on UCITS directive and proposed legislation on shadow banking) is carefully considered.

3. In your view, what could be meaningful thresholds in relation to the factors of size, interconnectedness, leverage, economic importance or any other factor to determine the critical relevance of any other non-bank financial institution?

4. Do you think that recovery and resolution tools and powers other than existing insolvency rules should be introduced also for other non-bank financial institutions?

- As stated in question 5, we support resolution tools being potentially available for all institutions belonging to an identified class, with resolution authorities having the ability to

use resolution tools on a specific institution if the trigger conditions are met and the resolution authority determines that use of the tools are necessary to achieve the resolution objectives. The use of ex ante thresholds or tests of systemic impact as a precondition for application of a resolution framework to individual firms is unnecessary, ineffective and potentially counterproductive. (But separately, we think the use of assessments of potential systemic impact are a useful tool at the point where an entity may be failing, to help determine whether and which resolution tools should be applied).

5. In your view, what could then be meaningful points of failure at which different types of other nonbank financial institution could be considered to fulfil the conditions for triggering:

a) The activation of any pre-determined recovery measures; or

b) Intervention by authorities to resolve the entity?

- The principles and conditions for applicability of recovery and resolution across all identified types of institutions should be consistent. The application of recovery measures should rely upon the firm's judgement and be agreed with the authorities as part of the recovery planning process. These should be a mix of qualitative and quantitative triggers.
- The application of resolution tools could be based on a determination that a firm is failing, or likely to fail, its regulatory conditions for authorisation and that it is not reasonably likely that action (other than resolution action) will be taken to enable the firm to meet the conditions for authorisation.

6. With respect to possible preventive and preparatory measures:

a) Do existing regulatory frameworks applicable to other nonbank financial institutions provide for sufficient safeguards, in particular with respect to their governance structures, market/counterparty/liquidity risk management, transparency, reporting of relevant information and other etc.?

b) Are supervisors equipped with sufficient powers to be able to collect information and monitor the various types of risks existing or building up in the particular nonbank financial sector/institution?

c) Are additional supervisory powers needed to ensure de-risking and prevent overly complex and interlinked operations?

d) Would recovery and resolution plans be necessary to be introduced for all or only some of these institutions? Why?

- With regard to sections (a) – (c) of this question, this will depend on the specific regulatory regime applied in each jurisdiction. The UK authorities assess that they have adequate powers but this should be kept under review as EMIR and (potentially) CSDR are implemented. We note that EMIR has a review process already set.
- With regard to (d) we note our answer to Q.5 of the main section.

7. With respect to possible <u>early intervention</u> powers and measures:

a) Do existing regulatory frameworks applicable to other nonbank financial institutions provide for effective early remedial actions of supervisors aimed at correcting solvency or operational problems at an early stage?

b) What other early intervention powers could be introduced?

- See our answer to Q22 of the main section.

8. With respect to possible <u>resolution</u> measures and tools:

a) Should administrative, non-judicial procedures and tools for the restructuring or managed dissolution of other failing nonbank financial institutions be introduced?

b) Depending on the entity, what could be the appropriate and specific resolution tools to be used? For which institutions are certain resolution tools or techniques not relevant? Why?

- Any financial institution that could be systemically significant or critical if it fails should be subject to a resolution regime that has the attributes set out in the FSB's Key Attributes. While the existing consultation covers the key financial institutions of concerns at this stage, it may be that work being undertaken by the FSB and others, for example examining shadow banks, identifies additional categories of financial institutions that should be considered in due course.
- On the question of tools, the Key Attributes make clear that jurisdictions should have in place a resolution regime that provides the resolution authority with a broad range of powers and options to resolve a firm that is no longer viable and has no reasonable prospect of being so. These tools should include both stabilisation (that is, transfer) powers and modified insolvency procedures.