

Consultation of the EU-Commission on a possible recovery and resolution framework for financial institutions other than banks

Comments of the German Insurance Association

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General comments:

The German insurance industry is seriously concerned that both the fundamental differences in the business models of banks and insurers and the adequacy of current insurance regulation and resolution regimes are not adequately reflected in the considerations of the EU-Commission. The adoption of a recovery and resolution approach which is evidently characterized by the attempt to minimize systemic risks in the banking sector could have unintended consequences in the insurance sector and is likely to harm the stability of the financial markets.

In detail:

➤ ***Resolution scenarios are not comparable between banks and insurers***

Unlike banks, the unique features of the insurance business model and the way insurance liabilities are funded and claims are settled, prevent insurers from experiencing emergency situations which are critical in terms of time. The arguments in support of this conclusion mainly derive from the long-term nature of insurance liabilities and the fact that investments and reserves are pre-funded by insurance premiums and carefully and effectively calibrated to match these liabilities. As it is very unlikely for insurance firms, or the whole sector for that matter, to experience rapid cash drains and outright runs, liquidity risk appears to be well contained and crisis situations do not occur literally “overnight”. And even in the case of insolvency, the long term nature of insurance liabilities and their extended run-off profiles, along with the tools available to regulators and their time for deliberate action, typically provide for orderly resolutions of insurance firms.

➤ ***Appropriate coordination is essential***

It is vitally important that the different work streams on global and regional or national level are sufficiently coordinated. The International Association of Insurance Supervisors (IAIS) is participating in a global initiative, along with other standard setters, central banks and financial sector supervisors, and under the purview of the Financial Stability Board (FSB) and G20, to identify global systemically important financial institutions (G-SIFIs). The focus of the IAIS analysis is in relation to potential Global Systemically Important Insurers (G-SIIs). At October 17, 2012, the IAIS has published proposed policy measures for G-SIIs which also deal with effective resolution. We believe that considerations on a recovery and resolution framework for –if any– systemically relevant insurers in Europe in advance of the final recommendations of the FSB confirmed by the G20 are premature. The EU-Commission should refrain from anticipating this discussion in order to avoid a different understanding than the global regulators which could cause competitive disadvantages for European insurers.

➤ ***Contradictive assumptions as regards the systemic relevance of insurers need to be avoided***

The problems arising from a lack of coordination become evident as regards the considerations of the Commission about the triggers for systemic relevance in insurance. According to the Commission, insurance undertakings solely committed to traditional insurance activities might also be designated as systemically relevant at a domestic level. We strictly oppose this assumption. It would violate the conclusion of the IAIS that insurers – while impacted by the financial crisis – engaged in traditional insurance activities were largely not a concern from a systemic risk perspective.

➤ ***Current framework is sufficient***

We believe that both the tools currently available to supervisors and the future framework for the supervision of insurance undertakings as provided by Solvency II ensure an orderly recovery and resolution. We fail to see which wider fallout effects arising from an insurer's financial distress are supposed to be not adequately captured by Solvency II and therefore would require establishing a separate framework. Title IV of the proposed Solvency II directive provides for recovery plans in cases where an insurer breaches the SCR. In this respect, the existing and proposed structure of insurance regulation acknowledges the nature of the traditional insurance model, and the prolonged time period in which situations develop. Apart from that, content and direction of recovery and resolution procedures depend of the concrete cause for the stressed situation. Given the possible myriad of causes it is hardly possible to anticipate them from an ex-ante perspective.

Questions raised by the EU-Commission:

Question 1:

Are the resolution tools applicable to traditional insurance considered above adequate? Should their articulation and application be further specified and harmonized at EU-level?

Yes. Experience gained so far from insolvency procedures for insurance undertakings have proved that supervisors have sufficient legal means at their disposal to intervene at any time in order to ensure an orderly resolution without the need for taxpayer's money. They already have access to a wide range of tools such as, among others, portfolio transfers and restructuring of liabilities which enable supervisors to work towards either to prevent insolvency or safeguard its process if insolvency is inevitable.

Against this background, the current resolution tools sufficiently address the risks both policyholders and other parties concerned might face in case of insolvency of an insurance company. Therefore, following the subsidiarity principle, no further harmonization at EU-level is required respectively even allowed. It is worth to mention that regulation details should rest with the discretion of national legislators to a considerable extent in order to align them with national insolvency law and other national characteristics.

Question 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?

No. We believe that – as a matter of principle – insurance companies do not qualify as systemically relevant. Due to the key characteristics of the insurance industry, insurer winding-downs are stable processes. These processes are governed appropriately at a member state-level.

We insistently disagree with the assumption stated in section 4.1.1 that there may be a higher risk that traditional insurance could be systemically important at a regional or national level. In various studies as well as in its proposed assessment methodology for G-SIIs released in May 2012, the IAS has provided compelling evidence that traditional insurance business

is not prone to systemic risk. We do not see any reason why this conclusion should be challenged at European level.

Likewise, we oppose the assessment that compulsory insurance and trade credit insurance are supposed to be systemically relevant due to their degree of interconnectedness with the real economy and their alleged lack of substitutability as stated in section 4.1.3. It is certainly true that the market for trade credit insurance is dominated by a comparatively low number of competitors. However, according to the numbers published by the Berne Union – which is the leading international association for the export credit and investment insurance industry – only 10% of the world wide exports are supported by insurance solutions. The vast majority of trade transactions are still operated without the involvement of insurers. Moreover, it is fair to predict that released capacities due to the assumed insolvency of one insurer will be soon consumed by other market participants given the promising return assumptions in trade credit insurance. Apart from that, the EU-Commission neglects the fact that there are other well-proven alternatives to mitigate credit risks such as, for instance, factoring.

However, we admit that there is a remote possibility that insurers might be engaged in bank-like activities which could trigger systemic impact if conducted on a very large scale. Nevertheless, the extent of these activities in the European and German insurance sector amounts to – as apparent – a negligible level in terms of systemic risk. Against this background, it needs to be clarified that the following comments and answers are not to be interpreted as an implied confession that systemically relevant insurers may currently exist in Europe.

Question 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?

Given the current legal framework, each insurance company is already orderly resolvable in case of insolvency. This would also apply to insurance companies potentially designated as systemically relevant. Apart from that, it is hardly possible to universally anticipate the scenarios where a wind-up procedure is necessary because every situation has a different impact on each individual insurance company.

Incidentally, it needs to be taken into account that Solvency II already provides for exhaustive stress test and correspondingly adjusted recovery plans. Therefore, we do not see which additional insights should be gained from separate stress tests for systemically relevant insurers.

Question 4:

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

The German insurance industry would agree that policyholder protection should be the predominant objective of any resolution process. This being said, we fail to recognize a conflict between policyholder protection and the public interest on financial market's stability. We believe that Solvency II also sufficiently addresses the needs of financial market's stability without further adjustments for systemically relevant insurers.

Question 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?

No. Contingency planning in crisis situations is already part of Solvency II. Furthermore, insurers are required to file recovery plans with the consent of the supervisor if the solvency capital requirement is breached. Recovery plans for systemically relevant insurers in excess thereof and from an ex ante-perspective will not provide additional value for supervisors. Instead, such plans are rather likely to obstruct the view for the real triggers of the crisis situation and impede the necessary flexibility to take adequate action.

Question 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?

No. The legal preconditions for the discontinuation and winding-up of business are regulated on member state level. There is no need for a separate determination of resolution triggers for systemically relevant insurers.

Question 7:

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

See comments on question 6.

Question 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?

No. Even if the catalogue of tools is partly identical with the powers available to insurance supervisors (i.e. remove and replace the senior management, appoint an administrator), the tools are adjusted to the specific needs of banks and financial market infrastructures and not suitable for the insurance sector. Insurance supervisors should refer to Solvency II which provides an exhaustive and tailored supervisory toolkit

Question 9:

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

See comments on question 8.

Question 10:

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

It needs to be carefully examined, based on the facts in each individual case, whether separation and segregation of assumed systemically relevant activities proves to be an effective measure. The corresponding discussion in the banking sector recently initiated by the Liikanen-report is still in its early stages. However, it is certain in any case that such an approach needs to be restricted to activities which undoubtedly have the potential to affect financial stability and the real economy. We are concerned that both the considerations in the Commission's paper and the assessment methodology provided by the IAIS eventually fail to define an appropriate dividing line for such activities. On the contrary, there is an immediate risk that fundamental elements of the core insurance business will be subject to an inadequate and counterproductive regulation.

The recapitalization of potential systemically relevant insurers by converting debt into equity (bail-in) is not a suitable measure in insurance. The insurance business model is funded by premiums collected in advance and not exposed to debts and leverage. For insurers legally structured as stock companies debts are of minor relevance. Thus, the effect on the overall capital targeted by bail-in-measures would be negligible. Instead, debts could be an important instrument for mutual insurers in order to enhance their capital base. Debt issuance is an important way for mutuals to get an equivalent access to the capital markets. This access would be impeded by compulsory bail-in since such instruments would be exposed to higher risks and therefore less attractive for investors.

Question 11:

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

Cross-border resolution of groups is a complex issue which raises many difficult questions and needs to be discussed not only for systemically relevant groups. The IAIS has released an “Issues Paper on Resolution of Cross-Border Legal Entities and Groups” in July 2011, providing an in-depth analysis of the various implications but without offering detailed standards and guidance. The IAIS announced to continue its work in this area. We recommend awaiting the results of this work stream before concrete initiatives are envisaged at European level. This general comment also applies to questions 11-15.

Apart from that, decisions in the resolution process should be made by the existing colleges. Any new arrangements that focus on cross-border issues should be based on an extension of the existing practice and co-operation of the Member States, rather than imposing a new framework at EU-level.

Question 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?

There is no indication that the respective authorities applying Title III of Directive 2009/138/EC and the Member State’s law do not take swift and effective decisions. As regards the internal policy within an insurance group the existing tasks and responsibilities remain in place also in a crisis situation.

Question 13:

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

No, the supervisory rules set forth by Directive 2009/138/EC should only apply to the going concern basis of insurance companies. By contrast, winding-up proceedings should be stipulated by Member State’s law only.

Question 14:

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

No, see comments on question 13. Furthermore, all issues eligible for harmonization are already regulated by Directive 2001/17/EC.

Question 15:

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

Basically yes. The decision as to whether signing a cooperation agreements with third countries should be independently taken by each EU Member State's authorities.

Berlin, 28 December, 2012