

January 3, 2016

**JOINT SUBMISSION OF NOLHGA AND NCIGF REGARDING  
FSB CONSULTATIVE DOCUMENT ON  
DEVELOPING EFFECTIVE RESOLUTION STRATEGIES AND PLANS**

The National Organization of Life and Health Insurance Guaranty Associations and the National Conference of Insurance Guaranty Funds respectfully submit their joint comments regarding the Financial Stability Board's consultative document titled, "Developing Effective Resolution Strategies and Plans for Systemically Important Insurers."

NOLHGA and NCIGF are an integral part of the insurance resolution process in the United States, preparing for and coordinating the provision of guaranty association benefits to U.S. insurance consumers whose insurance carriers become insolvent. NOLHGA's members are principally concerned with protecting consumers of failed life, annuity, and health insurers, and NCIGF's members are principally concerned with protecting consumers of failed property and casualty insurers.

NOLHGA and NCIGF's core concerns are that the consultative document undervalues the importance of policyholder protection and ignores the critical role that policyholder protection schemes play in the insurer resolution process. We offer these comments regarding how the consultative document might be strengthened and clarified in those respects.

***Question 1: Do you agree that authorities should identify institution specific resolution objectives as proposed in Section I? Are there any considerations relevant to that identification, additional to those discussed in this document, that should be covered in the Guidance?***

The consultative document states that "[a]uthorities should develop resolution strategies with the aim of maintaining financial stability and, *to the fullest extent possible*, protecting policyholders when an insurer fails."<sup>1</sup> We support the goal of maintaining financial stability, but we do not believe that it should be achieved in a way that compromises policyholder protection.

The United States and countries around the world have determined that insurance is a business affected with the public interest. The public's keen interest in making sure that insurance companies are able to pay claims whenever they come due is precisely why the business of insurance is so heavily regulated. Insurance regulation is all about policyholder protection, and the best way to protect policyholders is to make sure their claims are paid when due.

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<sup>1</sup> Consultative document, p. 10 (emphasis supplied).

Accordingly, we question the legitimacy of any resolution strategy that would deprive policyholders of fundamental contractual or statutory rights, including the absolute priority that insurance receivership statutes give policyholders over the lower ranking claims of general and subordinated creditors. Diverting an insolvent insurance entity's assets or restructuring its policyholder liabilities – so that payments can be made to lower priority counterparties – would deprive policyholders of significant protections and undermine the primary objective of insurance regulation.

***Question 2: Are the considerations for determining “points of entry into resolution” as discussed in Section II.1 appropriate and relevant for the insurance sector?***

The consultative document states that “[r]esolution strategies may involve the application of resolution tools at the holding or parent company level of a group; at the level of a subholding; *and/or* at subsidiary entities.”<sup>2</sup> In the U.S., any resolution strategy should include a resolution at the operating company level, unless the operating company is solvent and able to pay claims as they come due. Absent a resolution of the operating company, guaranty association benefits would not be available to help protect policyholders. (In the U.S., guaranty association statutory coverage obligations are triggered by an order of liquidation and a finding of insolvency for an operating insurance company.)

***Question 8: Are there any other issues in relation to resolution strategies and tools or the resolution of insurers generally that it would be helpful for the FSB to clarify in further guidance?***

While prior Financial Stability Board guidance emphasized the need for coordination between resolution authorities and policyholder protection schemes,<sup>3</sup> the consultative document seems to view policyholder protection schemes only as a source of funds, and not as an important partner in the insurance resolution process.<sup>4</sup> We believe that policyholder protection schemes can and should play an important role in developing or assessing resolution strategies, and therefore they should be part of crisis management groups and other coordination efforts.

The U.S. guaranty system – both on its own and in conjunction with regulators and receivers – has continually planned for the contingency of large and complex receiverships. Some of that work (involving realistic, albeit hypothetical scenarios) has been done for training and preparedness reasons. More importantly, a great deal of preparatory work has been done for specific, real-world situations where regulators were preparing for the possible liquidation of large and complex multi-insurer groups that were experiencing financial challenges. Fortunately, the good work of regulators and others ultimately succeeded in resolving the problems of some of those entities (including General American in 1999, Consec in 2002 and Security Benefit in 2009) without requiring the liquidation of their subsidiary insurers. In other instances (including Fremont Indemnity in 2003 and Lumbermens Mutual in 2013), close collaboration and planning by regulators and

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<sup>2</sup> Consultative document, p. 11 (emphasis supplied).

<sup>3</sup> See Key Attributes 8.1 and 12.1.

<sup>4</sup> See Consultative document, p. 24, in particular.

the guaranty system ensured a smooth transition to liquidation and coverage by the guaranty system.<sup>5</sup>

Because the guaranty system has been involved in almost all of the significant U.S. insurer insolvencies over the past 4 decades, it has a collective level of practical experience that is unmatched in the U.S. or elsewhere. That expertise can and should be used in connection with the resolution planning called for in the FSB's Key Attributes, including in connection with crisis management groups and other coordination efforts.

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Please see Appendix A for our suggested changes to the consultative document. We would be pleased to discuss our suggestions or answer any questions if that would be helpful.

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<sup>5</sup> In addition, NOLHGA was continually in consultation with NAIC leadership throughout the 2008-9 financial crisis about resolution steps that might have been necessary, had capital levels of major life insurance companies not remained as high as they did throughout a financial crisis that did so much damage to other sectors of the financial services industry.

## APPENDIX A

Page 10	Authorities should develop resolution strategies with the aim of maintaining financial stability and <del>to the fullest extent possible</del> , protecting policyholders when an insurer fails.
Page 10, fn. 11	The Key Attributes (KA 5.1) specify that resolution powers should be exercised in a way that respects the hierarchy of claims in liquidation, (Annex Section 5.1) but the resolution authorities should also have the flexibility to depart from the general principle of equal (pari passu) treatment of creditors of the same class. That flexibility would allow authorities, for example to treat policyholders of different types of policies or policyholders covered by a policyholder protection scheme versus policyholders not covered by such schemes differently in a resolution. That differential treatment may be justified if necessary to maximise the value for <del>creditors (including policyholders)</del> as a whole (subject to the “no creditor worse off” safeguard) or to minimise the potential systemic impact of a firm’s failure. <u>Policyholders should not be treated differently so that payments can be made to lower priority claimants.</u> Section 5.2 of II-Annex 2 states that there should be no differential treatment of policyholders that hold the same type of product or policies.
Page 10, fn. 12	Section 1 of KA II-Annex 2 (Objectives) acknowledges that policyholders might not be fully protected under all circumstances, and losses could be absorbed by policyholders to the extent they are not covered by policyholder protection schemes. <u>However, policyholders should not be required to absorb losses so that payments can be made to lower priority counterparties.</u>
Page 14	<i>Existence of Policyholder Protection Schemes (PPS)</i> - The choice of the preferred tools may also be affected by the existence of PPS or other forms of policyholder protection mechanisms, such as tied assets, that can be used to support the use of resolution tools. For example, they may contribute funds to facilitate a transfer to a bridge insurer or other insurer or a creditor financed recapitalisation. They may also compensate policyholders for their losses in the event of run-off on an insolvent basis or a wind-up and liquidation (see Section III.5). <u>In addition, policyholder protection schemes can play an important role in developing or assessing resolution strategies, and they should be part of crisis management groups and other coordination efforts.</u>
Page 24	In jurisdictions where it is available, the PPS <u>can play a vital role in developing or assessing resolution strategies as part of the crisis management group.</u> <u>In addition, the PPS</u> (or other mechanism for policyholder protection, such as tied assets) may have an important role in supporting the use of resolution tools by contributing funds. Authorities should assess the availability and scope of cover under PPS and the extent to which PPS can assist in securing continuity of insurance cover and payments, and in particular:  (i) whether the PPS has the legal and financial capability (including the ability to borrow from the public <u>or private</u> sector) to help fund resolution actions as a means of securing continuity of insurance cover and payments, for example

	<p>through a transfer of insurance policies or by contributing funds that would otherwise be obtained by a write-down of policyholders' claims; and</p> <p>(ii) where the PPS is responsible for making payments to policyholders, the extent to which the PPS has the operational and financial capability (including the ability to borrow from the public <u>or private</u> sector) to make payments under the insurance policy.</p>
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