Insurer resolution framework – Executive Summary

Insurer failures can have harmful effects on individuals and businesses, economic activity and financial stability. Resolution is a way to manage the failure of financial institutions, including insurers, that prevents severe systemic disruption without exposing taxpayers to loss.

International standards for insurer resolution frameworks

There are two sets of international standards applicable to insurer resolution developed by the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS). The two standard setters work to align the standards as appropriate when they cover the same institutions.[1]

The FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes) are the international resolution standard for all types of financial institution, including insurers, that could be systemically important if they fail. The standard consists of 12 Key Attributes (KAs) that set out the core elements of resolution frameworks. These include resolution objectives, resolution powers and safeguards, resolution planning and arrangements for cross-border coordination. The 12 KAs are supplemented by sector-specific implementation guidance, including guidance on how the KAs apply to insurers.

The IAIS Insurance Core Principles (ICPs) include provisions on resolution and apply to the supervision of all types of insurer. ICP 12 covers all measures for insurance market exit, including resolution for systemic failures, together with other aspects of resolution frameworks, such as resolution preparation, plans and coordination. The *Common Framework for the Supervision of Internationally Active Insurance Groups* (ComFrame) adds provisions to the ICPs that apply specifically to internationally active insurance groups (IAIGs).

Resolution objectives

Resolution involves the exercise of resolution powers by a resolution authority with a mandate to achieve specific objectives. These include preserving financial stability through the continuity of the failed institution's economically or socially important functions and the protection of policyholders, beneficiaries and claimants. That protection is usually achieved by using resolution powers to ensure continuity of insurance coverage. However, this does not imply that policyholders will be fully protected in all circumstances. In a resolution, shareholders and unsecured and uninsured creditors absorb losses in a manner that respects the hierarchy of claims. Policyholders may suffer losses if they are not covered by a policyholder protection scheme.

[1] Both the FSB and the IAIS have produced practical guidance to supplement their standards on insurer resolution. Such guidance includes the IAIS's Application Paper on Resolution Powers and Planning, the FSB's guidance on Developing Effective Resolution Strategies and Plans for Systemically Important Insurers, the FSB's practices papers on Identification of Critical Functions of Insurers and Resolution Funding for Insurers, and its report Scope of Insurers Subject to the Recovery and Resolution Planning Requirements in the FSB Key Attributes. The FSB has also developed a Key Attributes Assessment Methodology for the Insurance Sector.

Resolution powers for insurers

The FSB and IAIS standards specify a set of resolution powers and tools designed to ensure that authorities can manage failed insurers in an orderly manner.

Powers of control and management: Resolution frameworks must empower authorities to take control of a failing insurer directly or through an appointed administrator, remove and replace the insurer's directors and senior management, and take the management actions necessary to conduct its core activities and achieve an orderly resolution.

Restructuring powers (transfer and bail-in): Resolution authorities must have powers to carry out a sale or merger of a failing insurer and to transfer assets, rights and liabilities, including insurance portfolios, to another entity. Authorities should also have powers to write down and restructure liabilities, including insurance liabilities. This is known as "bail-in" and allows losses of a failing insurer to be absorbed by its creditors and policyholders without putting it into an insolvency procedure.

Powers to suspend third-party actions: Resolution authorities must be able to restrict or prevent third parties from exercising rights or taking actions that could undermine the effectiveness of resolution. This includes policyholders' withdrawal and surrender rights, reinsurers' termination rights and early termination rights in financial contracts. Suspension powers are used to provide stability for a limited period while the authority prepares and implements restructuring measures.

Powers to place an insurer into run-off or liquidation: Resolution frameworks must enable authorities to put an insurer into run-off or effect its closure and orderly wind-down (liquidation). An insurer in run-off cannot write new business but continues to carry out existing insurance contracts.

Those powers must be explicit, allow resolution authorities to override rights of shareholders and creditors, and be exercisable without requiring consent of shareholders and creditors. These features are necessary for rapid and legally certain intervention.

Since resolution powers are likely to interfere with property rights, their use is subject to safeguards that should be set out in the resolution framework. The most important is the "no creditor worse off" (NCWO) safeguard, which gives shareholders and creditors a right to financial compensation if their losses in resolution are greater than the losses they would have suffered if the insurer had been liquidated.

Resolution planning

For resolution to be a credible option, authorities and insurers need to prepare through resolution planning carried out during "business as usual". The FSB and IAIS standards specify that resolution plans should be maintained, at a minimum, for any insurer that could be systemically significant or critical if it fails. Both standard setters set out criteria for authorities to assess which insurers should be subject to a resolution plan based on their nature, scale, complexity, interconnectedness, substitutability and cross-border operations.

Firm-specific plans set out the preferred resolution strategy and a detailed operational plan for its implementation. IAIGs or other insurance groups that could be systemic in failure may be subject to a group-wide resolution plan. Resolution plans must be regularly reviewed and updated when necessary, and authorities should conduct regular resolvability assessments to ensure that the firm's resolution strategy remains credible and feasible.

Cross-border coordination

For insurers that operate in multiple jurisdictions, resolution planning and execution require cross-border information-sharing and coordination between authorities. To facilitate that, the FSB and IAIS standards require appropriate cooperative arrangements to be in place. For the most systemic IAIGs, the usual forum for such cooperation is the firm's crisis management group (CMG). A firm-specific CMG brings together the group's key home and host supervisory and resolution authorities. Its operation is underpinned by a cooperation agreement that delineates roles and responsibilities and sets out expectations about information-sharing. During business as usual, the CMG is used for resolution planning and assessing resolvability. In a crisis, it is used to share information and coordinate actions for the group's resolution.

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