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Preserving the Value of Diversification in Resolution

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A & M

Introduction

The focus of today's presentation is to set out a proposed resolution regime for international reinsurers with the purpose of achieving the objectives set out in the FSB's resolution framework

The views expressed in this presentation are those of the presenter and not necessarily of Alvarez & Marsal

Preserving the Value of Diversification in Resolution

- The financial crisis resulted in a global agreement to address the systemic and moral hazard risks associated with the ‘too-big-to-fail’ problem of SIFIs
- The FSB developed a regime aimed at the ability to resolve SIFIs in an orderly manner without taxpayer exposure to loss from solvency support and ensuring continuity of institutions’ critical functions
- Many of the FSB’s measures are driven by responses to a banking-led crisis and necessarily reduce the causes of bank systemicness: size; interconnectedness; and complexity
- There is ongoing debate on whether applying banking-type measures are needed or suited to address systemic risk in (re)insurance, and whether (re)insurance is systemic at all
- Adopting banking-style policies, which aim to reduce the size and geographic activity of firms (key sources of diversification for international reinsurers), may do more harm than good
- Resolution authorities should instead focus on measures to preserve economic value by ensuring that diversification, especially international diversification, is not destroyed in or prior to resolution
- Policy should aim to enhance the natural substitutability of international reinsurers, supplemented by effective monitoring and enhanced supervision

Contents

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Economic importance of international diversification

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From the perspective of the financial sector facilitating the real economy – there is something very valuable in international diversification

In terms of realising all the international diversification that the real economy needs, the international reinsurers are actually too small

(Re)insurance business model

- Transferring risks which are either too large / expensive for individuals / companies to bear
- The larger the size of the insurance portfolio the greater benefit conferred from diversification
- Protection risks are usually idiosyncratic in nature and not correlated with the economic business cycle, enabling diversification to take place. The same is not true for savings risks (longevity, reinvestment etc)

Economic value of international reinsurance

- Reinsurers are generally able to bear the largest and most complex risks by benefiting from larger and more diversified portfolios than primary insurers. Fungibility of capital across national boundaries is a pre-requisite
- International diversification:
  1) Means that the receiver of the risk can take it at much better price from the point of view of the policyholder
  2) Thus extends the boundaries of insurability

Societal benefits

- Academic research points to prosperity and high insurance penetration being heavily correlated
- However it is not fully understood which is cause and effect, and undoubtedly causality goes in both directions

Insurance is an important and necessary function for the economy but individual insurance companies are substitutable

- Generally, in the event of insurer failure, the impact has been local and the resultant gap has been covered within a short period, and insurance capacity was quickly restored to pre-failure levels (e.g. Failure of Gerling, 2002)
- There are examples of when insurance capacity could not be replaced at acceptable prices leading to unaffordable levels of protection:
  - many of the causes have been the result of poor governance, insufficient competition and failures of microprudential supervision (e.g. Failure of HIH, 2001)
- Limited evidence of insurance either generating or amplifying systemic risk within the financial system or real economy
- Historical lack of globally systemic damage does not ensure that in the future such an event would not occur
- Policymakers have responded to this risk by including primary insurers and reinsurers within the scope of the 'Too-Big-to-Fail' macroprudential regime

The notion that insurance poses systemic risk is deeply controversial

‘Neither long experience of insurance markets nor information arising from the global financial crisis provides any evidence of traditional insurance either generating or amplifying systemic risk’ **IAIS**

The IAIS notes the following important differences between the business models of insurance and banks:

- Insured events are usually idiosyncratic & can be diversified
- Insurance claims are not likely to significantly increase in times of financial turmoil
- The nature of liquidity risk is operational rather than strategic –insurers do not typically experience liquidity ‘runs’
- Traditional insurers are not involved in maturity transformation or credit intermediation and are less dependent on the economic cycle
- The interconnectedness within the insurance sector is small
- Insurance insolvency does not require a rapid liquidation of assets to meet short-term liabilities as it with banks

Although historical evidence suggests that insurance does not pose systemic risk, due to in part to high substitutability, there has not been a case of a international insurance failure upon which to test this assumption fully

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Global resolution initiatives

The role of the FSB in developing global macroprudential policy

- In 2009, the G20 empowered the FSB with a mandate to promote financial stability, and to take action on resolution, intensive supervision and additional capital, liquidity and other prudential requirements. The aim was to
  - ensure that the regulatory system for banks and other financial firms reins in the excesses that led to the crisis;
  - develop resolutions tools and frameworks to help mitigate the disruption of SIFI failures;
  - to reduce moral hazard;
  - and to set prudential standards commensurate with the costs of their failure .
- The FSB created three working groups for banks (SIBs), insurance (SIIs) and non-bank, non-insurance (NBNI SIBs) respectively, with the goal of creating policy frameworks for global SIFIs comprising:
  - a published methodology for their identification;
  - annual publication by the FSB of lists of G-SIFIs; and
  - publication of the policy measures that are to be applied by national authorities to those institutions.

Policy efforts for G-SIBs are the most advanced, followed by G-SIIs and NBNI-SIBs, as a result many of the criteria for identifying systemic banks and related policy measures have been applied to G-SIIs

The FSB considers that an effective resolution regime should achieve two things: firstly authorities should be able to resolve financial institutions in an orderly manner without taxpayer exposure to loss; and secondly that the continuity of institutions' critical functions should be maintained

The FSB framework to identify systemically important firms

Systemic risk

- The FSB defines systemic risk as a '*disruption to the flow of financial services that is (i) caused by an impairment of all or parts of the financial system; and (ii) has the potential to have serious negative consequences for the real economy*'
- Concepts fundamental to this definition: (i) systemic events are associated with negative externalities; (ii) an impairment or disruption to the flow of financial services; and (iii) significant spillovers to the real economy

Criteria for identifying systemic risk

- The FSB framework identifies G-SIFIs using three key criteria to identify systemic importance :
  1) **size** (the volume of financial services provided by the individual component of the financial system);
  2) **substitutability** (the extent to which other components of the system can provide the same services in the event of a failure); and
  3) **interconnectedness** (linkages with other components of the financial system)
- The BCBS published its assessment methodology to identify G-SIBs in November 2011 (updated in 2013) and included two additional indicators of systemic importance:
  4) **cross-jurisdictional activity** (cross-jurisdictional claims and cross-jurisdictional liabilities); and
  5) **complexity** (notional amount of OTC derivatives, Level 3 assets, and trading and available-for-sale securities)

At the request of the FSB, **the IAIS** has undertaken efforts to develop an effective resolution regime for G-SIIs and has to date published: an initial identification methodology, currently under consultation; and policy measures

G-SII assessment methodology

IAIS emphasises that 'traditional' insurance is not a source of systemic risk, through indicator weightings

The IAIS's G-SII assessment methodology identifies five indicators of insurance systemic risk:

1. **Size**: Importance increases with the amount of financial services provided;
2. **Substitutability**: Systemic importance increases where it is difficult for the components of the system to provide the same or similar services in the event of failure;
3. **Interconnectedness**: Systemic risk can arise through direct and indirect connections with the rest of the financial system, in particular the banking system;
4. **Global activity**: The extent to which failure can have negative externalities on a global scale; and
5. **Asset liquidation**: The extent to which an insurer's failure could potentially transmit systemic risk to the financial system through the asset liquidation channel (BCBS included 'complexity under the G-SIB methodology)

The IAIS places greater emphasis on asset liquidation and interconnectedness (85% weighting combined), rather than size, substitutability and global activity (5% respectively). The BCBS framework applied equal importance for banks

The IAIS is currently consulting on an 'activities-based approach' which by comparison looks at the risk facing many firms across the sector, rather than the risk facing a single firm.

- The ABA considers how even solvent firms, through their collective risk exposure, may propagate or amplify shocks to the rest of the financial system and the real economy

The FSB's approach towards G-SII resolution

The FSB approach towards G-SII resolution consists of:

i. Identifying the preferred resolution strategy

- The first stage of a resolution strategy is to identify the point, or points, of entry within an insurance group to which authorities can best apply resolution tools to achieve their objectives. The approach proposes two 'stylised' resolution strategies:

  a) non-operating holding or sub-holding company (topco); and

  b) individual operating entity (opco) point of entry

ii. Identifying preferred resolution tools

- The tools, in line with the FSB's Key Attributes, can be summarised in three groups:

  a) stabilisation and restructuring tools (e.g. Bail-in);

  b) winding-down tools; and

  c) stay and suspension powers

iii. Strategic analysis underlying the development of the resolution strategy

- An authority's strategy should be tailored to the insurer's specific risks, critical functions, potential systemic impact of failure, with the aim of protecting policyholders

- FSB guidance is limited for reinsurance

Issues of applying a banking resolution regime to insurance

- There is broad consensus that certain core banking activities give rise to systemic risk, principally driven by the size, substitutability, interconnectedness with the rest of the financial system, global activity and complexity
- The FSB and national authorities have available a set of tools which reduce sources of systemicness
- Many of the sources of systemic banking risk (size, global activity and internal interconnectedness) are <u>sources of strength for insurers</u>. The consequence of applying bank-specific measures to insurance constrains diversification
- In the case of insurance, <u>diversification of insurance continues to be relevant even when you have a reinsurer of global scale</u>. This is a contrast to the banking sector where diversification benefit ceases to be relevant before you get to scale of largest banks
- If an internationally diversified reinsurer was twice the size and had twice the business, there would be a lot more diversification benefit. Conversely, if an internationally diversified bank was twice the size and had twice the business there would not necessarily be as much benefit
- If an international diversified reinsurer was half the size, if there were two half the size, there would be a significant loss of diversification benefit. The same thing would not occur if there were two international banks of half the size.

3 Diversification preserving resolution strategies

Diversification preserving resolution strategies for international reinsurers

- A resolution regime needs achieve the nine objectives set out in the FSB's Key Attributes (KAs). The KAs distinguish between (i) stabilisation options and (ii) liquidation options.
  - The former achieve continuity of systemically important, i.e. critical, functions, and the latter orderly closure and wind-down of all or parts of the firm's business in a manner that protects policyholders
- The question to be asked is whether international reinsurers perform a critical function, the continuity of which should be a policy aim
- This question may be asked both in respect of "flow" and of "stock":
  - At the point of failure should one solely seek to protect the interests of cedent insurers in respect of reinsurance policies already contracted, or
  - Should one seek to ensure their continued access to policy renewals and new policies from that reinsurer?
  - And even in respect of policies already issued is such protection need to protect against systemic harm or is it solely motivated by the micro-prudential policyholder protection objective?
- In order to answer these questions one needs to look at the definition of critical functions

Objectives of the FSB's Key Attributes

- The KAs refer to the interaction of the resolution regime and the applicable schemes and arrangements for policyholder protection
  - One should not try to make the resolution regime alone do all the work. That would neither be efficient nor successful.
- When considering the appropriate resolution regime for a reinsurer it is relevant to look to the regulation and supervision of the underlying direct insurance and to the policyholder protection funds (where in place)
- **Resolution for an international reinsurer is necessarily a cross-border issue**.
  - The Key Attributes states that "Jurisdictions should seek convergence in their resolution regimes"
  - This is of particular importance in respect of international reinsurance

Objectives of the KAs

1) ensure continuity of systemically important financial services [ie critical] functions …;
2) protect insurance policy holders …;
3) allocate losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims;
4) not rely on public solvency support and not create an expectation that such support will be available;
5) avoid unnecessary destruction of value, and therefore seek to minimise the overall costs of resolution in home and host jurisdictions and, where consistent with the other objectives, losses for creditors;
6) provide for speed and transparency and as much predictability as possible through legal and procedural clarity and advanced planning for orderly resolution;
7) provide a mandate in law for cooperation, information exchange and coordination domestically and with relevant foreign resolution authorities before and during a resolution;
8) ensure that non-viable firms can exit the market in an orderly way; and
9) be credible, and thereby enhance market discipline and provide incentives for market-based solutions.

FSB's approach for identifying reinsurance critical functions

- The FSB sets out a three-step approach to identifying critical functions:

  1. The impact assessment of the sudden discontinuance of international reinsurance provided by a single reinsurance group on financial stability and the real economy.

  2. The substitutability analysis for an international reinsurance provided by a single reinsurance group

  3. The firm-specific test for a particular reinsurer of its materiality to the supply of international reinsurance

- **The FSB document all three steps are needed for a function to be critical**

With respect to the second and third steps the case is not made out

Substitutability of international reinsurance

There are two main sources of evidence as to the substitutability of international reinsurance: (i) the historical evidence, and (ii) the evidence from an analysis of the current market structure.

(i) Historical evidence

- A long period (in excess of 100 years) of cross-border reinsurance without crystallisation of global systemic risk;
- The substitution of new supply following the failure of large reinsurers including during periods when there was general stress to the reinsurance market (e.g. Gerling)
- The resilience of the international reinsurers to recent unprecedented natural and manmade loss events

(i) Current market structure

- Intense competition between international reinsurers and host jurisdictions – neither having a dominant market position
- Reinsurance policyholders are by definition sophisticated buyers – typically have access to a wide range of reinsurers
- Reinsurance expertise is highly transferable, and is not necessarily lost even when a reinsurer fails .
- The boundary between traditional reinsurers and alternative capital providers is blurring
- The ESRB states that "Studies suggest that failure of a reinsurer can have an impact on individual insurers but not across the sector or beyond that to the financial system."

In the absence of such an insurance sector or financial system impact, the failure of a reinsurer would only be systemic if it led to the non-viability of an individual cedent insurer that was itself systemically important

Substitutability of ‘stock’ and ‘flow’ of international reinsurance

The evidence is that international reinsurance is important to the real economy, but

‘Flow’ – its continued supply as respects new policy flow (including policy renewals) is not a critical function as such supply is substitutable and/or not overly concentrated in any one reinsurer;

‘Stock’ – its continued supply as respects the performance of the stock of reinsurance contracts existing at the point of failure of an international reinsurer is not a critical function as it is not overly concentrated in any one reinsurer;

Possible exceptions

- An individual cedent insurer that is itself systemically-important, has a concentrated reinsurance exposure to a single international reinsurer
- Common vulnerabilities across the international reinsurance sector that lead to a heightened risk of correlated defaults by international reinsurers
  - However, cedents’ exposure could be mitigated by ceding to a larger reinsurer rather than several smaller reinsurers

Positive resolution strategies

The policy focus therefore should be on:

- **A** Wind-down rather than stabilisation tools, and especially not a priori or pre-packaged stabilisation tools;
- **B** Enhancing or maintaining the natural substitutability of reinsurance;
- **C** Enhanced supervision of (globally or domestically) systemically-important cedent insurers, including oversight and limitation of their concentration risk to any particular reinsurer and to the reinsurance sector in the aggregate;
- **D** Continued and enhanced monitoring of reinsurance markets by the IAIS and the FSB to give early warning that the evidence as to substitutability is changing and early warning as to the emergence of common vulnerabilities across the international reinsurance sector;
- **E** Preserving international diversification during wind down; and
- **F** **Effective micro-prudential supervision** of reinsurers, including especially pricing discipline

Ⓐ Pre-packaged stabilisation options neither needed or desirable

An a priori or pre-packaged stabilisation option to ensure the continuity of international reinsurance as a critical function is not needed

- The supply of international reinsurance is of high importance to the real economy, but it is substitutable
- If an international reinsurance group is undertaking systemic non-insurance business then stabilisation options may be necessary – with it focus on the continuity of that non-insurance business
- The point is not that stablisation tools should never be used, but that there does not need to be a pre-packaged stablisation option, e.g. with debt pre-placed as available for bail-in
- The risk of public sector support, which pre-packaged solutions address, does not arise as its substitutability prevents it being a critical function
- The FSB identifies stabilization tools for a (re)insurer as including sale or transfer of the (re)insurer's shares, sale or transfer of the (re)insurance portfolios and/or a creditor-financed recapitalisation of the (re)insurer
- These tools are not needed to ensure that continuity of supply of international reinsurance as a critical function, but may be useful as tools to achieve other aims, e.g. policyholder protection, avoidance of unnecessary destruction of value, allocation of losses, and for speed, transparency and predictability

For these purposes a regime prescribing a minimum level of bail-in debt – such as the TLAC or MREL regimes for banks – is neither necessary nor desirable

B Enhancing the natural substitutability of international reinsurance

The focus of policy actions and inactions should be to maintain and enhance the natural substitutability, in particular looking to barriers to entry, growth and innovation

- The essence of reinsurance is diversification not only within, but across different, kinds of risk and the essence of international reinsurance is such diversification also across borders.
- Reinsurance becomes less substitutable as the market is fragmented either by geography, type of risk or other circumstance.
- **Here policy inaction may be as important as policy actions**. Policy actions and inactions should aim at:
  - Increasing the supply, and especially the diversity of supply, of the pool of capital invested in reinsurance.
  - Removing the barriers to the use of substitutes to traditional reinsurance, such as for example natural catastrophe bonds.
  - Removing barriers to entry and to growth for new and challenger reinsurers, and to new and challenger jurisdictions as home for reinsurers.
  - Enabling (cedent) insurers as buyers of international reinsurance to make informed choices
  - Focusing regulation of international reinsurance especially on the maintenance of pricing discipline

Ⓒ Enhanced supervision of systemically-important cedent insurers

The default of a failed reinsurer that leads to the failure and default of an individual direct insurer does not necessarily have a material impact on the financial system or the real economy. That depends on whether, and, if so, how critical the direct insurance is

- Systemically-important insurers – whether domestic or global – are unlikely to be large either in number or in aggregate size relative to the global direct insurance market
- The FSB has only designated nine globally systemically-important insurers
  - The US FSOC domestic designations with respect to US have not identified any insurer not on this global list.
- The most proportionate way to break any failure-link as between a reinsurer and a systemically-important direct insurer is to take measure within the supervision of those few systemically-important direct insurers rather than across the entire international reinsurance sector.
- Probably most effective measure would be for the enhanced supervision of a systemically-important insurer to include oversight and limitation on its concentration risk to any particular reinsurer and to the reinsurance sector in the aggregate

D Continued & enhanced monitoring of reinsurance markets by the IAIS & FSB

Continued and enhanced monitoring of reinsurance markets by the IAIS and the FSB is needed to give early warning that the evidence as to substitutability is changing and early warning as to the emergence of common vulnerabilities across the international reinsurance sector

- Continued and enhanced monitoring of reinsurance markets is fully in keeping with the objectives, and current activities, of both the IAIS and the FSB.
- The IAIS lists as its objectives:

  i. "*promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and*

  ii. to contribute to global financial stability."

- In pursuit of these objectives the IAIS published annual Global Reinsurance Market Reports, GRMR, from 2004 to 2011, and then from 2012 onwards annual Global Insurance Market Reports, GIMAR.
- The tasks of the FSB include "*assess vulnerabilities affecting the global financial system and identify and review on a timely and ongoing basis within a macroprudential perspective, the regulatory, supervisory and related actions needed to address them, and their outcomes*".

E Preserving international diversification during wind down

Preserving value for policyholder or for depositors is desirable in pursuit policyholder protection or depositor protection objectives even where it is not necessary for the avoidance of systemic harm

- Financial institution creates value for their clients by performing an **economic function**, e.g.
  - for banks it might be the simultaneous provision of liquidity and interest on a deposit, but
  - for an international reinsurer it is the indemnification of risk that only becomes insurable through diversification within the reinsurer at a global level
- When a financial institution fails the first question to be asked is service provided to clients is a **critical function** in respect of **new supply**. If not stabilisation options for the purpose of securing continued new supply is not needed.
- The next question to be asked is how one preserves value for existing clients in respect of the **stock of supply** of the service already in place at the time the financial institution fails, e.g.
  - for a failed bank the stock of deposits in place or
  - for a failed reinsurer the stock of reinsurance already contracted
- A failed financial institution has two basic possible ways left to it of preserving some value for its clients through wind down. These are:
  1. **performance in situ**, that is it may continue itself to perform the service contracted; or
  2. **liquidation** and payout of an estimate of the outstanding value of the unperformed service

Ⓔ Preserving international diversification during wind down (cont'd)

If liquidation and payout of international reinsurance occurs, replacement of key services may be less easy than is the case for banks

- **When a bank fails** the amount of its deposit liabilities tends to be known and <u>subject to little uncertainty</u>
  - The key services the bank provides with respect to such liabilities are and/or interest.
  - Upon failure the key priority for the resolution authorities is to ensure either the rapid repayment of those deposits or their transfer to another bank
  - For a deposit – typically repayment of the deposit or value of the investment is for a <u>client at least as good as, if not better than, performance in situ</u>
- In contrast to the policyholder of a **failed (re)insurer**:
  - The key service provided is protection against the cost of an <u>uncertain event</u>
  - This may be a past event whose outcome is not yet fully known, or it may be a future event, that is one that would fall in an already-contracted but not yet expired policy coverage period.
  - <u>The utility of a payout may be significantly less than that of performance</u>

Ⓔ Preserving international diversification during wind down (cont'd)

Replacement of existing in-force international reinsurance immediately upon the failure of a international reinsurer has several challenges

- The supply of new international reinsurance (including the renewal of existing insurance) to a cedent insurer is substitutable

- In contrast, the replacement of existing in-force international reinsurance immediately upon the failure of an international reinsurer may prove less easy for the following reasons:

  - The renewal of a stock of existing reinsurance policies would typically occur evenly <u>over a 12-month period</u>

  - <u>Policyholders are already out-of-pocket</u> in respect of the premium paid for the unexpired periods still left on existing in-force reinsurance policies

  - <u>Policyholders will have incurred but not yet settled</u> (and in some cases not yet even reported) claims on the existing reinsurance policies.

  - The price of replacement cover would reflect the particular circumstances of the cedent insurer <u>at the time the replacement was</u> purchased (and those circumstances might be quite different from those prevailing at the time of the original purchase of the reinsurance)

As a result, performance of reinsurance contracts during the wind down of an international reinsurer is likely to be <u>significantly better</u> at preserving value for cedent insurers than liquidation and payout

E Preserving international diversification during wind down (cont'd)

Performance in-situ / run-off may also be preferred in **insolvency** – the choice would be between *partial* performance and liquidation with only *partial* payout

- In the insolvency cases the performance and/or payout would only be partial, i.e. the pro-rata share that the insolvent reinsurer could afford
- Both run off and liquidation raise questions of how equitable treatment as between policyholders is to be maintained.
  i. For **run-off** the risk is that claims settled early may receive a higher pro-rata pay out than those settled later
  ii. For **liquidation and payout** the risk of inequity is between claims whose amounts are known and those which are still subject high uncertainty. The latter need to be quantified for payout in advance of those uncertainties crystallising.
- Both the run off and the liquidation approaches have been extensively used in practice for failed reinsurers, but the former has been used more frequently reflecting the preference of cedent insurers
- The problem of equitable treatment is dealt with by initially setting a very low pro-rata payout. As better than the worst case occurs the pro-rata payout is increased and applied retrospectively to settled claims.
- **Although this is a reasonably effective method of ensuring equitable treatment it deprives cedent insurers of much of the benefit of a run-off approach: they remain unsure how much reinsurance coverage they still have in place until the latter stages of the run off**

E Preserving international diversification during wind down (cont'd)

The focus of regulatory action during run-off should be to help a reinsurer manage and mitigate uncertainty

- **Prior to the failure** of an international reinsurer this might include strong micro-prudential supervision of its capability to quantify insurance claims during periods of stress, e.g. following a very large natural catastrophe, and contingency planning to ensure this capability would remain in place even if the international reinsurer were to fail
- **Subsequent to failure** this should include enabling the international reinsurer to continue to manage and mitigate risk on the basis of the international pooling of risk
- The latter (continued international pooling of risk) is important as:
  1. The volatility of outcomes for the global pool would be significantly less than for sub-global pools
  2. This greater sub-pool volatility might lead to the need for a more cautious (i.e. lower) initial pay-out rata which would significantly negate the ability of run-off to preserve more value for the cedent insurers vs. liquidation.
  3. The aggregate of the capital that would be needed for each sub-pool if an international reinsurance group were broken up, would be more than the total that would be needed if it were kept together

Either extra capital or extra caution in the initial pay-out ratios would be needed to offset the loss of international diversification that would occur if a failed international reinsurer were broken up

F Effective micro-prudential supervision of international reinsurers

Strong pricing discipline by international reinsurers is fundamental to reducing the risk of correlated defaults by international reinsurers

- Strong pricing discipline needs to be (and is) a focus of the IAIS's global surveillance of the reinsurance market and of the micro-prudential supervision of national insurance supervisors
- The ESRB sets out four reasons it considers why direct insurance might be systemic:
  - i. Procyclicality in asset allocation;
  - ii. Procyclicality in the pricing and writing of insurance related to economic activities such as credit and mortgage insurance;
  - iii. Common vulnerability to a double-hit scenario; and
  - iv. Lack of substitutes in vital lines of insurance business.
- Items i) and iii) are unlikely to be material outside the life insurance sector. They are not relevant to the international reinsurance sector in its role as a supplier of international diversification for non-financial insurance risks.
- The key to items ii) and iv) is the prolonged absence of pricing discipline left unnoticed and uncorrected by microprudential supervision
- **International reinsurance helps to impose pricing discipline – it is part of the solution to these problems**
- **However, key to this is that international reinsurers themselves maintaining strong pricing discipline**

Cross-border effectiveness

Resolution strategies for international reinsurers are necessarily cross-border issues

- International reinsurers are unlikely to be systemically important as reinsurance is not a critical function
- However, in our view the core themes of the FSB's Key Attributes and Principles for Cross-border Effectiveness of Resolution Actions are suitable for application to an international reinsurer but with the focus of facilitating the preservation of international diversification during run off
- In particular in our view:

a) An institution-specific cross-border **cooperation agreement** should be put in place for each large international reinsurance group

b) Development of a **recovery and resolution plan** ("RRP") with the agreed path for resolution to be run-off, keeping the international reinsurance group in tact so as to preserve international diversification.

c) The removal of automatic triggers, statutory and/or contractual, that might apply on the commencement of a winding up

d) Empowerment of authorities in host jurisdictions of branches & subsidiaries to take actions to recognise & enforce the actions of the home-jurisdiction authorities and to support the aims of those actions with actions of their own

e) Alignment across jurisdictions of regulatory regimes that apply to solvent and insolvent reinsurers, in particular so that they aim for equitable treatment of all creditors without discrimination based on nationality or location

4 Questions

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