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Recovery and resolution planning – where are we and what's next?

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The objectives of this workshop are to:

- Discuss the purpose of recovery and resolution planning
- Outline why it is important for insurers (and actuaries)
- Overcoming challenges in practical implementation

Introduction

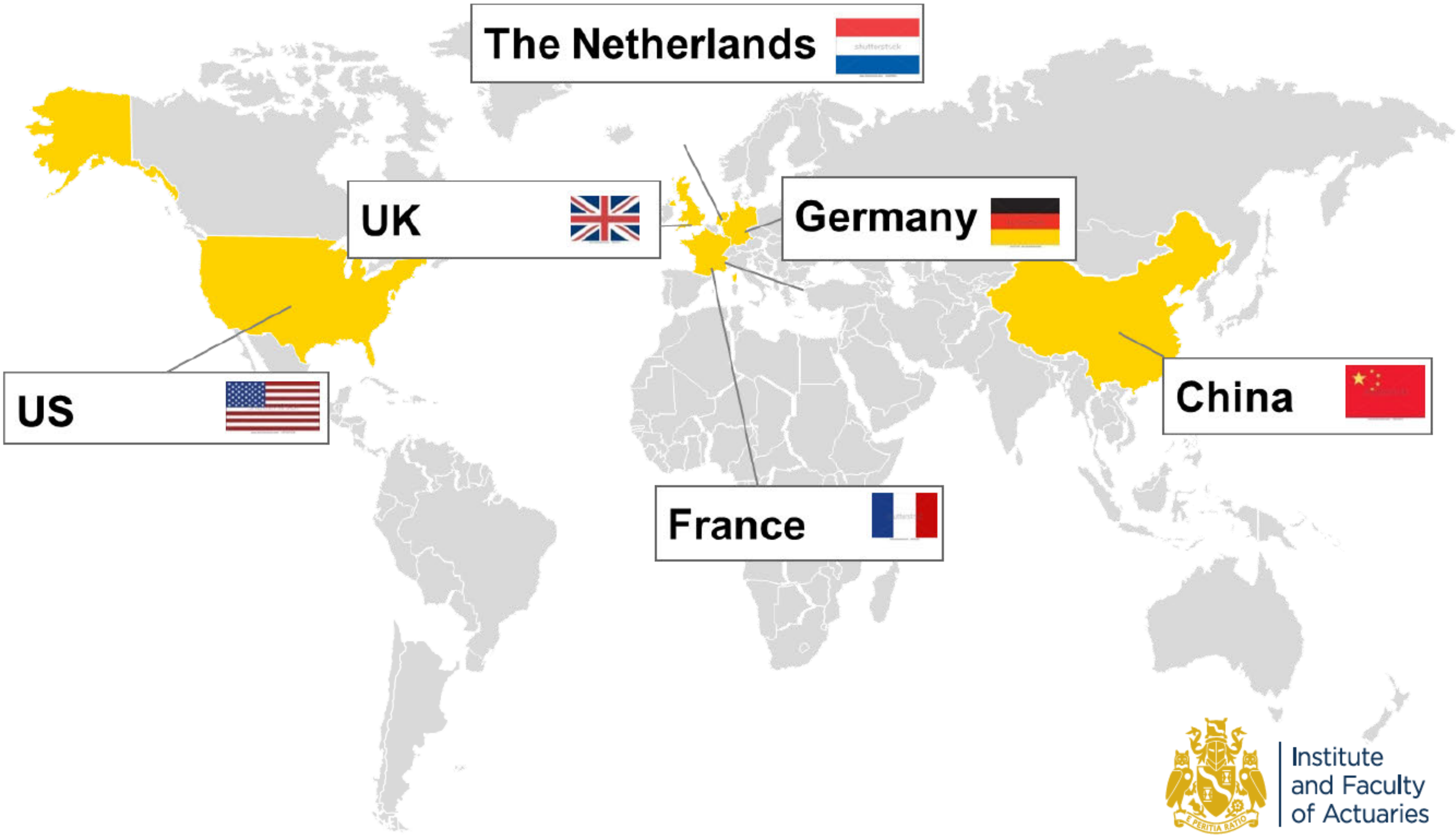
Why do insurance companies (nearly) fail?

Insurance company	Year	Country	What happened?
Western Pacific	2011	New Zealand	Claims related to New Zealand earthquake.
Quinn	2010	Ireland	Breached regulatory solvency requirements. Guarantees provided to non-insurance arms.
Fortis/Ageas	2010	Netherlands & Belgium	Acquisition of ABN Amro prior to financial crisis significantly reduced capital coverage.
AIG	2008	US	Rapid growth, including in areas outside its traditional expertise. (e.g. subprime mortgages). Compounded by governance and ERM issues.
US casualty insurers (e.g. Mission, Transit)	2002-2005	US	Insufficient claims reserves on casualty lines following a period of inadequate pricing industry-wide compounded by weak risk management.
Independent	2001	UK	Under-pricing and rapid expansion into new market s and new products.
HIH	2001	Australia	Overexpansion. Exposure to Californian workers' comp. Dominant management style.
Equitable Life	2000	UK	Under-pricing of guarantees embedded into annuity products and overuse of equities to back liabilities.
General American	1995	US	Inability to meet high surrender demands.
Several US insurers (e.g. Executive Life, Monarch).	1990s	US	Several US life insurance companies failed due to a combination of illiquid asset concentrations and lack of liquidity to meet maturing liabilities.

The path to resilient and resolvable firms

- Firms' BAU approach is often not enough to recover from a crisis
- Bail-outs are unaffordable to taxpayers – but failure is worse
- The level of integration and interdependence between firms is often poorly understood
- A strong incentive for development of new frameworks to improve resilience and respond to crisis.

Global coverage - Designated G-SIIs



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Recovery & Resolution Plans (RRP) – What is it?

Definitions	Purpose	Uses: The Insurer	Uses: The Authorities
Recovery Plan (RCP) A **Recovery Plan (RCP)** would be triggered when a financial institution is subject to extreme stress situations. The plan outlines actions designed to maintain the firm as a going concern.	**Preventative** Save the insurer	Sets out the framework and steps the institution itself would initiate to recover from a stress situation	Provides the Authorities with confidence that the Institution can recover from a severe stress situation
Resolution Plan (RSP) A **Resolution Plan (RSP)** would be triggered in the event of the failure of a financial institution, and would facilitate its resolution in a controlled manner, with the minimum of public cost and systemic disruption.	**Contingency** Enable the Authorities to resolve the insurer	Sets out the framework in the event of failure and should demonstrate the ease of resolvability and minimal need for ex-ante action	Provides the Authorities with a clearly articulated approach to resolve a failed institution, identifying any needs for ex-ante action

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Regulatory position

Drivers for RRP – basis of regulatory requests

Home regulators	e.g. PRA, Finma, BaFin, ACPR, CBI, IVASS
EIOPA	Crisis management principles Stress tests, microprudential tools of RRP
ESRB	All insurers should develop recovery and resolution plans
European Commission	All insurers should be ready with recovery and resolution plans – NCA led
IMF	Insurers contribute to systemic risk – improved transparency, focus on international capital standards, contagion, required
FSB	Systemically important insurers should have recovery and resolution plans

Message is reinforced at global, international, European and domestic levels that resolution planning is required for insurers

Regulators are prioritising insurers who have:

- High market ranking
- Concentration in annuities
- Altered capital structure
- Undertaking acquisitions or restructuring
- Material international business

Boards are asking for recovery plans to:

- Ensure that they have a practical tool kit to manage a crisis.
- Lack of confidence in material legal entity projections.
- Non exec directors have experience of RRP from banks and are raising questions

The PRA is prioritising Category 1 and 2 insurers

"A firm must prepare for resolution in the event of failure so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services."

Fundamental Rule 8

Category 1

Insurers whose size (including number of policyholders) and type of business mean that there is very significant capacity to cause disruption to the interests of a substantial number of policyholders.

Category 2

Insurers whose size (including number of policyholders) and type of business mean that there is significant capacity to cause disruption to the interests of a substantial number of policyholders.

FR8 applies to all insurers in the UK

PRA PS5/14 June 2014

- Discussions vary depending upon insurers' systemic importance, proximity to failure, types of products, corporate structure, transactions or other reasons
- Expectation that insurers will be responsive to discussions as they take place
- Key issues are strategic in nature
- Compliance will need to be judged in the context of an insurer's own perception of its resolvability
- A recovery plan is a precursor to a resolution plan (often developed in parallel).
- FCA will also review recovery plans, looking at conduct related implications of recovery options and management of conduct risks throughout recovery and resolution.

PRA approach

The PRA's 'Proactive Intervention Framework' sets out 5 stages of 'crisis' within which different recovery options are considered :

Stages in the PIF		Recovery & Resolution Actions
Stage1	Low risk to viability of insurer	Recovery ▸ Insurer will be required to plan for stressed conditions, identify appropriate recovery actions and or exit strategies Resolution ▸ PRA to assess insurer resolvability
Stage 2	Moderate risk to viability of insurer	Recovery ▸ Insurer will be required to reassess recovery actions and exit strategies ▸ The PRA may set additional reporting requirements , require realignment of capital and restrict activities Resolution ▸ PRA will instigate any initial contingency planning needed
Stage 3	Risk to viability absent action by insurer	Recovery ▸ Insurer will be required to submit a recovery plan in a timely manner and initiate recovery actions which may include capital raising, asset disposal, sale/transfer of insurance business, changes to management. The PRA may restrict new business Resolution ▸ PRA will intensify resolution planning needed
Stage 4	Imminent risk to viability of insurer	Recovery ▸ PRA will most likely remove all capability to write new business ▸ Insurer will be required to accelerate and complete all recovery actions Resolution ▸ PRA will complete all resolution actions, including planning for orderly liquidation or administration with an insolvency practitioner in waiting
Stage 5	Insurer in resolution or being actively wound up	Resolution ▸ PRA will trigger the appropriate insolvency process and the insolvency practitioner will work with the PRA and FSCS to effect continuity of cover and or compensation to eligible claimants

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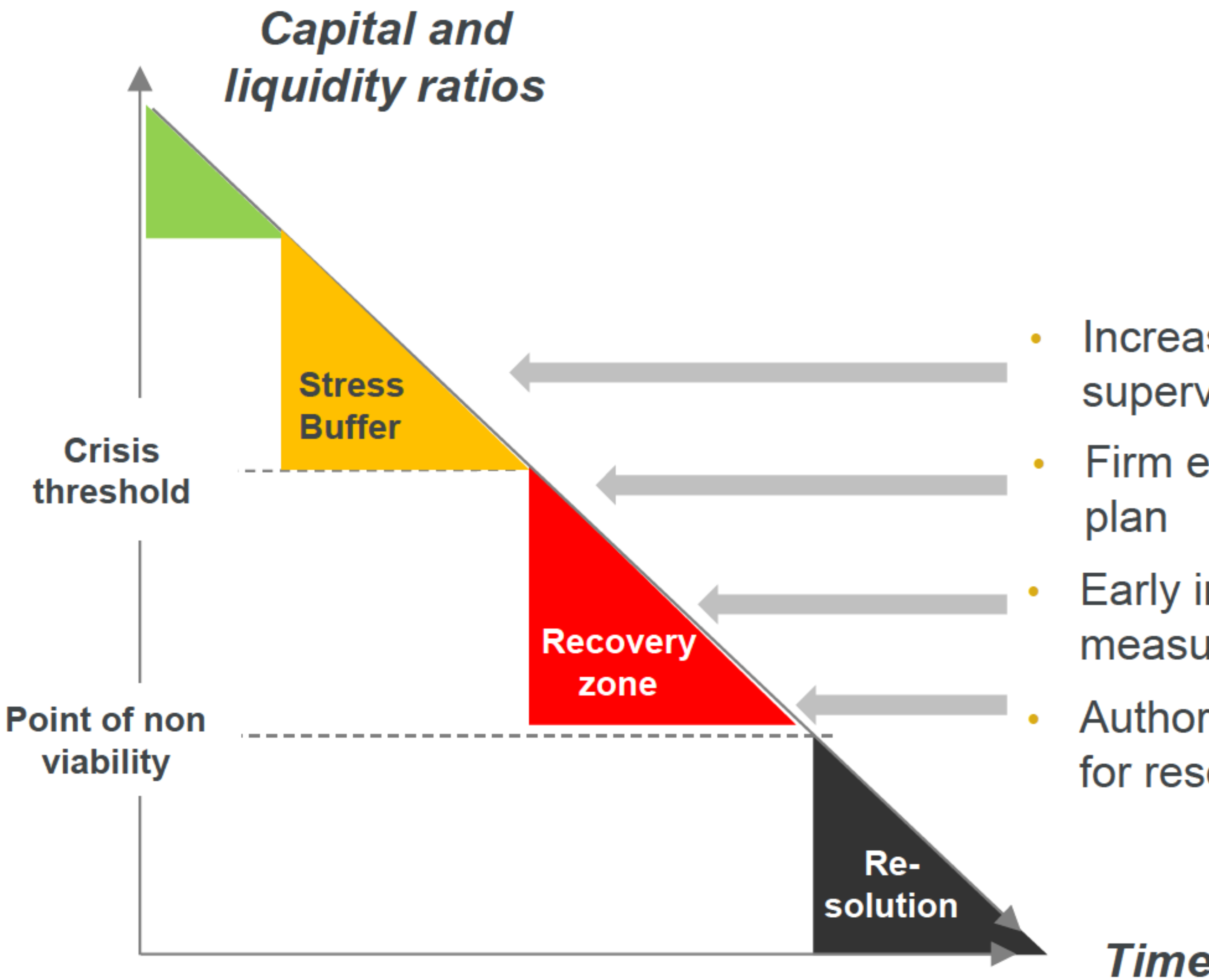
Focus on Recovery Planning

EY RRP Framework ('The Slippery Slope')



- Increased regulatory supervision
- Firm executes its recovery plan
- Early intervention measures
- Authorities prepare for resolution

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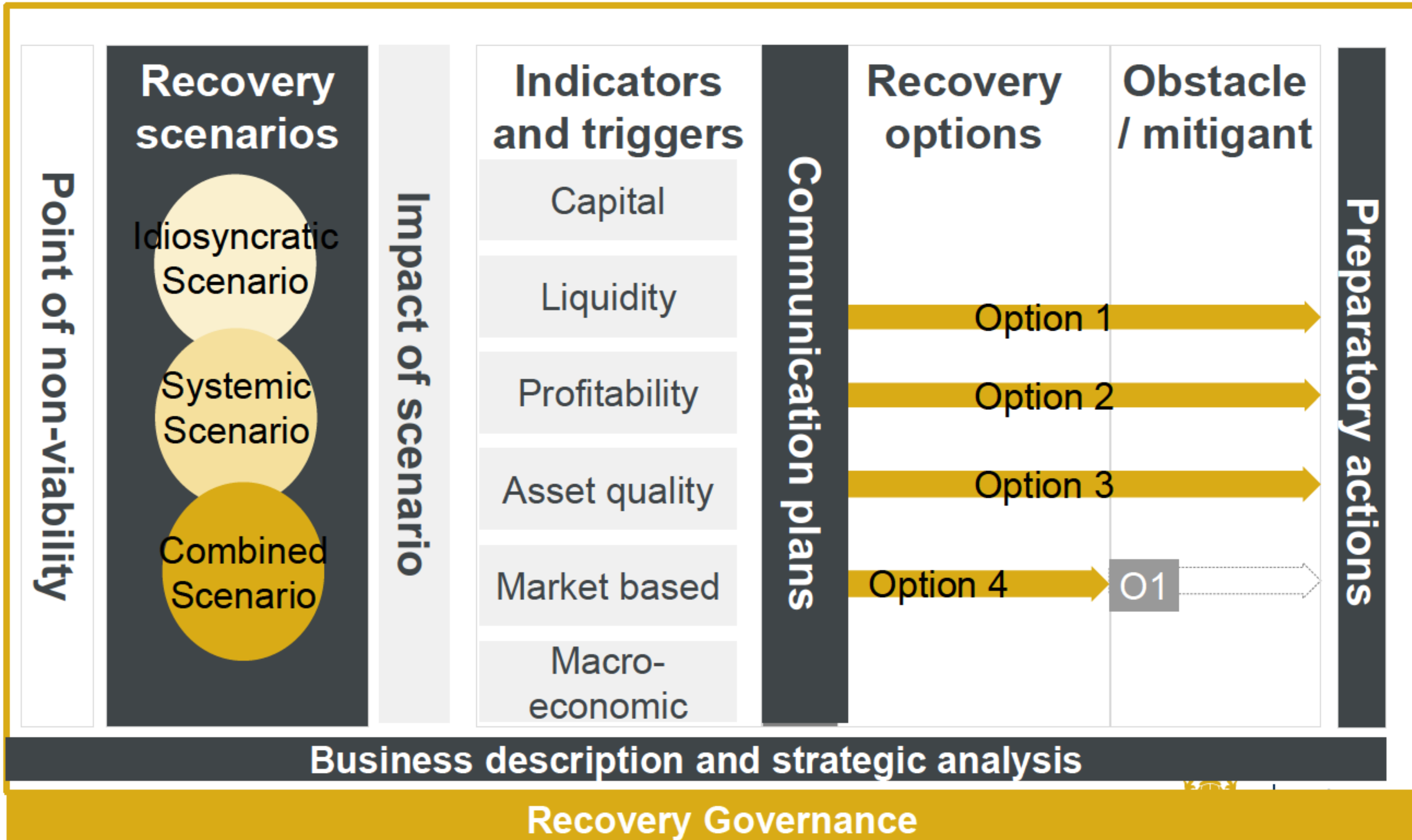
Key components of a Recovery Plan



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Potential recovery actions

Area of focus	Recovery actions
Divestments	Disposal of underperforming portfolios
	Discontinue activities and sell renewals
	Disposal of entities (asset management, insurance subs – life and non life)
Cost reduction	Redundancies, bonus cuts
	Outsourcing, centralisation of functions,
Underwriting	Adjust pricing / reserving assumptions
	Reduce retention and unlock capital through reinsurance
Asset management	Asset de-risking (equities, private equity, alternative investments, securitised products)
	Property sale and leaseback
	Reduction in duration of assets / de-risking
	Hedging programme
Shareholder contribution	Rights issue
	Stop or reduce dividend payment
	Convertible perpetual capital
	Stop share buy-back programme
	Capital injection

Scenario testing and recovery options

- <u>**Systemic/idiosyncratic**</u> - A systemic event is one that impacts a meaningful proportion of insurers and other financial institutions. An idiosyncratic event would be chosen to specifically impact the insurer in question with limited wider impact.
- <u>**Liquidity/capital**</u> - This should cover whether the event results in a liquidity or capital (solvency) problem, or both.
- <u>**Fast/slow**</u> - The scenarios should look at fast events (e.g. sudden financial shocks) as well as slow events where there is a prolonged period of (say) under performance.
- <u>**Failure of largest counter-parties**</u> - Where the insurer has a large counter-party (e.g. a reinsurer, lending bank or outsourced supplier) the insurer should consider the ability of the identified recovery options to address problems arising from failure of these major counter-parties
- <u>**Operational losses**</u> - Within the insurance industry and in connection with other financial institutions very substantial operational losses can arise (e.g. conduct issues). These should be considered when testing recovery options.

Characteristics of successful Recovery Plans

- Forming a small, senior central team
- Clarity over interdependencies throughout the global firm
- Identifying point of non-viability and scale of recovery required
- Building on existing stress testing experience, but focusing on macro level scenarios and impacts – avoiding detailed economic analysis if possible
- Knowing when to declare a 'crisis'
- Focusing recovery on a relatively short menu of truly material, practical actions
- Agreeing what will not be volunteered as a potential action
- Establishing strong governance and crisis management structure within the Plan and within defined parameters

#1 issue is lack of practicality to the plan

Completeness

Quality

Credibility

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Resolution Planning

Resolution planning approach for firms

Key areas	Keys to an effective resolution strategy
Determination of a preferred strategy	• Identify points of entry into resolution • Identify scope of resolution – legal entities, core business lines, critical functions
Strategic analysis underlying the development of the resolution strategy	• Key factors to consider: • Business segments • Critical functions • Operational continuity (critical shared services) • Cross-border cooperation • Role of policyholder protection schemes (PPS) • Nature and location of loss-absorbing capacity in resolution • Funding and liquidity
Making the resolution strategy operational	• Detailed resolution plans for each point of entry should be developed to implement the strategy, reflecting the features of the insurer's structure and business model; • Ensure strategies are adaptable to different failure scenarios, considering alternative options accordingly; • Develop a clear understanding of the factors triggering resolution actions; • Cooperation between host and home authorities part of the CMG;

Features of groups affecting resolution

- **Financial indebtedness**
  - External debt issued by MLEs (Material legal entities)
  - Intra-group loans between MLEs
  - Derivative contracts/ ISDAs

- **Guarantees and Indemnities**
  - Guarantees issued by MLEs to other group companies, for the benefit of external third parties.
  - Indemnities issued by MLEs to other group companies and external third parties

- **Reinsurance**
  - Material internal reinsurance contracts in place between MLEs. Impact when unwound/ recaptured?

- **Operations**
  - Critical Service Providers (CSPs) providing services to MLEs to carry out day to day operations.
  - Funding of CSPs. Working capital?
  - CSPs reliance on key third party applications, platforms and service providers

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Conclusions

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- Insurers can and do fail
- Recovery and Resolution Plans are useful tools
- Demand for plans will to continue to increase

Questions

Comments

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