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Recovery and Resolution Plans in Banking and Insurance

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23 November 2017

Disclaimer

The views expressed in this presentation are those of the presenter(s) and not necessarily of Milliman, Permanent tsb and PRMIA.

Introduction

Focus of today's presentation:

- Latest developments regarding recovery and resolution for (re)insurers and case studies to explore the available tool-kit
- Recovery Plans in banking and what key lessons may be learnt from it.



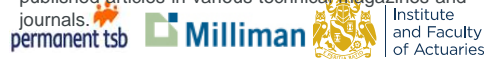
Bridget MacDonnell is a risk consultant, working at Milliman, and has recently co-authored a white paper entitled "Recovery and Resolution Plans: Dealing with Financial Distress". Bridget was a member of the Actuarial Association of Europe (AAE) working group who prepared a draft response for the EIOPA discussion paper regarding a harmonised recovery and resolution regime.

Bridget is a member of the Enterprise Risk Management Committee of the Society of Actuaries in Ireland (SAI) and has previously presented on this topic at a SAI evening meeting.



Dr Monika Smatralova is a senior risk practitioner currently leading the Supervisory Review and Evaluation Process within Group Risk, Permanent tsb. Her academic background is in 'Financial Management'. She has been working in risk functions of major high street and captive banks for the last 10 years focusing mainly on credit and operational risk management and measurement, and Enterprise risk management.

Monika is also actively involved in the senior leadership at PRMIA, successfully leading the Irish Chapter since 2013. In 2014 she was elected as the EMEA Regional Directors Committee Co Chair and member of PRMIA Global Council. In 2015 Monika joined the PRMIA Educational Committee. She is a co-author of the PRM designation text books and has published articles in various technical magazines and journals.



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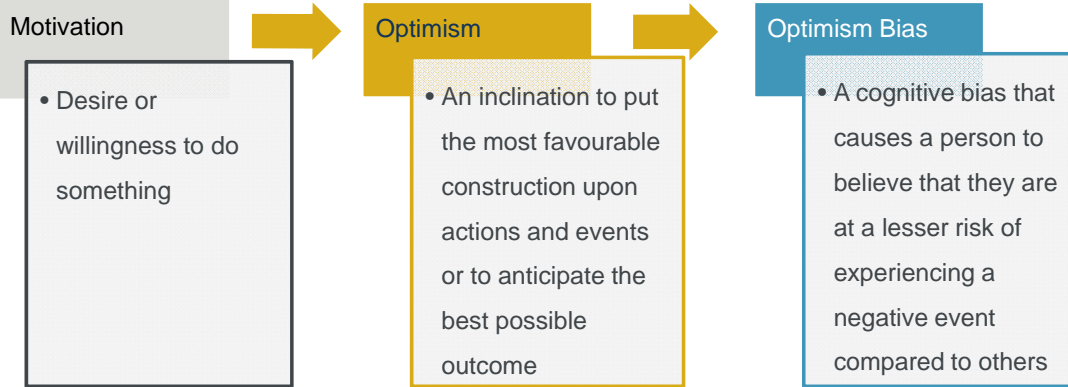


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Recovery and Resolution in Insurance

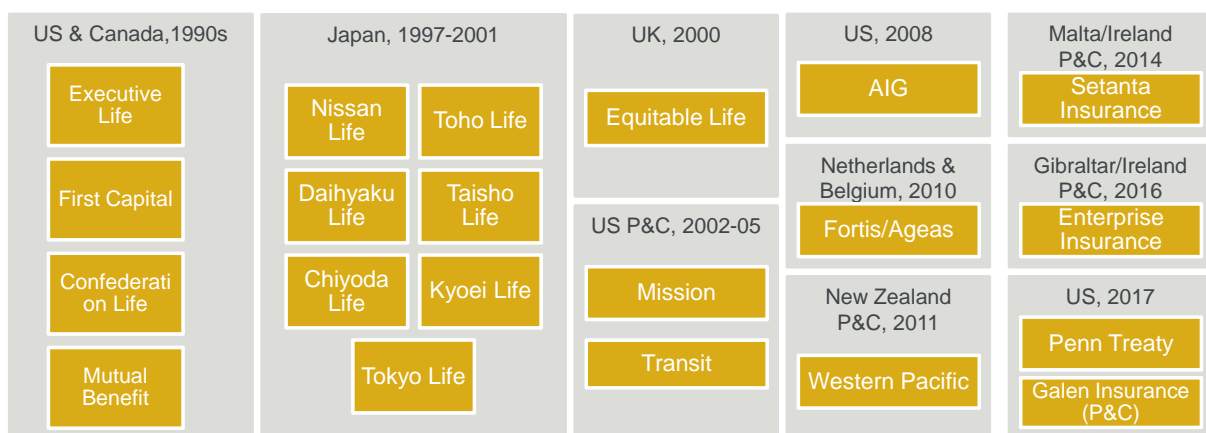
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“Failure is not an option”



Resilience: An ability to recover from or adjust easily to misfortune or change

Examples of Past Insurer Failures (or near failures)



And many more...

Financial Stability Board (FSB) Definitions

Recovery Plan:

- “Identifies options to restore financial strength and viability when the firm comes under severe stress”

Resolution:

- “When a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so”

Current requirements for large companies

- G-SIFIs must undertake recovery and resolution planning
- IAIS requirements adopted for Global Systemically Important Insurers (G-SIIs), Includes 5 EU insurance groups: **Aegon N.V., Allianz SE, Aviva plc, Axa S.A. and Prudential plc**

PRA’s Fundamental Rule 8 is for all insurance companies to have a resolution plan

- No current plans to issue guidance

France: law introduced permitting regulator to require preventive recovery plans and a national resolution regime for the insurance sector (Dec 2016)

Netherlands: The authorities are working on a new national law regarding recovery and resolution for the insurance industry to be implemented in 2018

Romania: adopted a recovery and resolution framework for all insurers in accordance with the FSB Key Attributes



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EIOPA Opinion – Recovery and Resolution Framework

Building Blocks	
1. Preparation and planning	Pre-emptive recovery planning
	Pre-emptive resolution planning
	Resolvability assessment Early intervention
2. Early intervention	Early intervention conditions
	Early intervention powers
Recovery	Solvency II ladder of intervention – out of scope Resolution
3. Resolution	Resolution authority
	Objectives, Conditions, Powers, Safeguards
4. Cooperation and coordination	Cross-border cooperation and coordination arrangements

EIOPA have called for a harmonised recovery and resolution framework for all (re)insurers in July 2017 following a qualitative assessment and consultation:

- Minimum harmonisation
- Recovery plans
- Early intervention powers not a new capital requirement
- Resolution powers – aim to preserve value
- “...relevant in fragile market environments, like the current low interest rate environment”

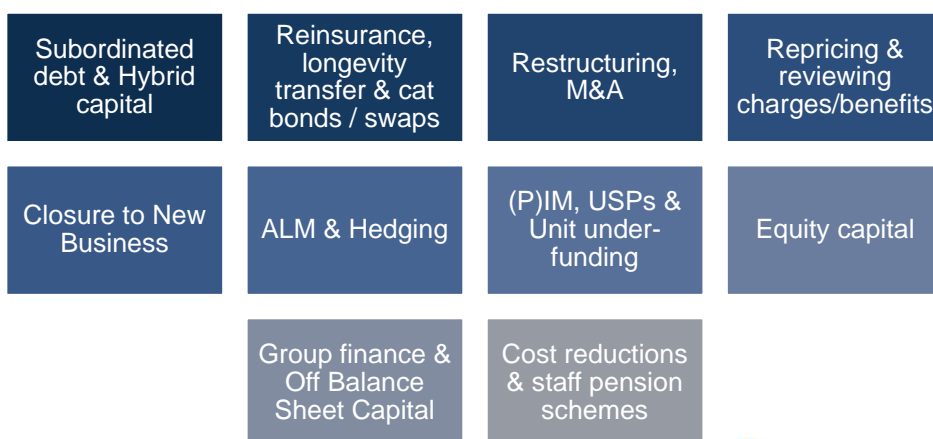


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EIOPA Opinion – Recovery Plans

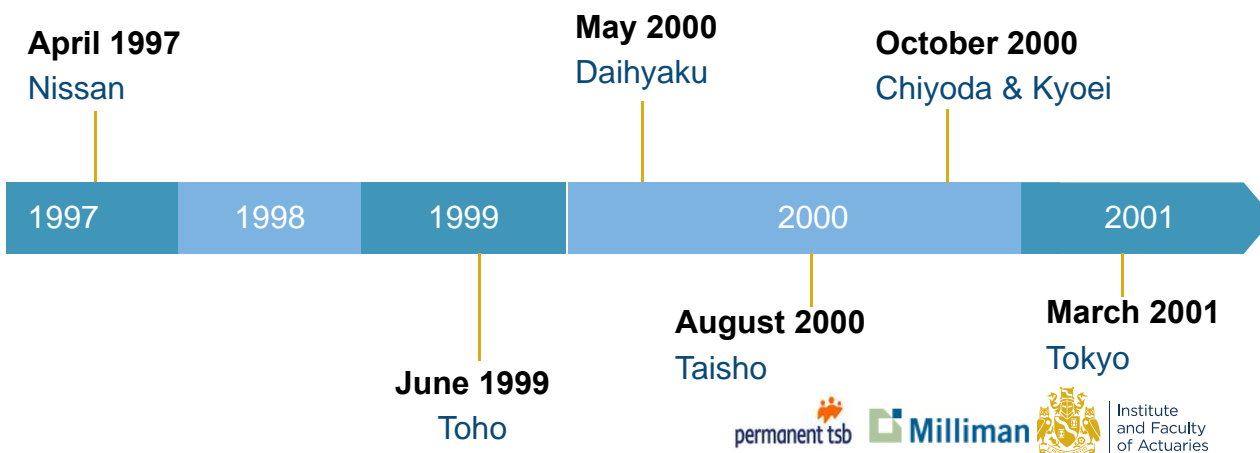
- Pre-emptive – drafted before observation of non-compliance with the Solvency Capital Requirement
- Developed at the group level but solo supervisors may require development at the solo level
- A natural extension of the ORSA and contingency planning, which are a source of input
- Exact content to be further defined – should at least contain a strategic analysis with a description of the entities covered and possible recovery options to be used across a range of stress scenarios, and the following:
 - Detailed description of insurer’s legal structure, business model, core business lines and (if relevant) essential functions whose disruption could harm the financial stability and/or economy
 - Severe stress scenarios to the extent that these are not already covered in the ORSA – idiosyncratic and systemic
 - Assessment of necessary steps and time needed to implement recovery measures
 - Communication plan covering the communication strategy of insurers with the authorities, public, financial markets, staff and other stakeholders.

Possible Recovery Measures



Case Study: Resolution in Japan – 1997-2001

Timeline of events



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Evolution of Japanese Resolution Process (1997-2001)

- Establishment of Policyholder Protection Fund and industry body (the "LIAJ")
- Failed attempt at "Oldco/Newco" restructuring plans
- 1998 – Policyholder Protection Corporation (PPC) established
- Court-appointed rehabilitation trustee working together with the PPC
- Capital provided by the white knight & financial assistance from PPC
- Policyholder reserve/cash value reduction (limited to 10%)
- Reduction in guaranteed interest rate
- Possible policyholder participation in future upside (dividends)

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Case Study: Prudential Financial, Inc. Resolution Plan

Why Published?

- 2015 Resolution Plan (public section) filed with the Federal Deposit Insurance Corporation (FDIC)
- Required under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* – for nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Federal Reserve .

Key points

- Drafted by the company – unlikely to be the case under the EIOPA proposed framework where regulator will draft the resolution plans
- Information contained is a useful guide for companies as to the kind of information regulators may seek in order to draft the resolution plan – allows companies to start preparing for the information requests



Case Study: Prudential Financial, Inc. Resolution Plan

Legal Entities

- Legal entities – split total assets, liabilities and net income for each legal entity and describe historic development of legal entity structures
- Mapping of interconnectedness of legal entities e.g. outstanding inter-affiliate loans:

Funding provider	Legal entity receiving funds									
	PFI	PICA	PALAC	PRIAC	PLAZ	POJ	GIB	PMCC	PIM	Non-MLEs
PFI					X			X		X
PICA					X				X	X
PALAC		X								
PRIAC									X	X
PLAZ									X	X
POJ	X						X	X		
GIB	X	X								X
PMCC	X									
PIM										X
Non-MLEs	X	X	X	X	X		X			

Non-MLEs: Non-Material Legal Entities



Case Study: Prudential Financial, Inc. Resolution Plan

Resolution Strategy

- Prudential would be reorganized through a proceeding under Chapter 11 of the Bankruptcy Code
- Material legal entities that are U.S. insurance companies would undergo rehabilitation under the respective state insurance statutes
- PGF, Prudential's central derivatives conduit entity, would be liquidated under Chapter 11 of the Bankruptcy Code

Steps Taken to Improve Resolvability

- Dissolution of two legal entities
- Development of a Legal Entity Management Policy
- Capital management actions – simplified the operating structure and enhanced its financial flexibility by making available capital, for example:
 - Redeemed its holding company debt and repurchased and cancelled its Class B Stock related to its Closed Block



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Recovery and Resolution in Banking

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Introduction to Recovery and Resolution in Banking

“We don’t want banks to assume they can hold up their hands and get money whenever they are in crisis just because we are a cash rich country. Banks should assume no reliance on public funding going forward”. Regulator













- Established by Regulation (EU) No 806/2014 on the Single Resolution Mechanism (SRM Regulation), the Single Resolution Board (SRB) has been operational as an independent European Union (EU) Agency since January 2015.
- 2017 is the third year of drafting recovery plans for banks.
- And it is **still evolving on both sides...**
- Resolutions Plans are drafted by the regulator and only partially shared with the banks.



Elements of Recovery Plans

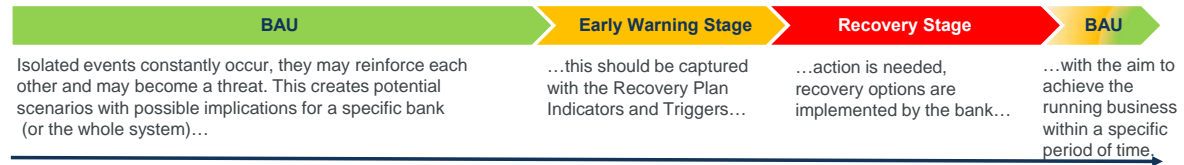
*“Banks should develop recovery plans that identify **credible** options to survive a range of severe but plausible stressed scenarios.” Regulator*

Key Building Blocks :

- | | |
|---|--|
|  1. Governance |  6. Recovery Plan Indicators & Triggers |
|  2. Documentation and Data |  7. Recovery Options |
|  3. Integration |  8. Scenarios |
|  4. Scope |  9. Testing, feasibility and updating |
|  5. Critical functions |  10. Communication |



So how it works practically....



Scenarios	Indicators	Recovery Measures/Options	Indicators
Idio-syncratic (fast)	Impact	<ul style="list-style-type: none"> Capital Raising &/or Preservation Restructuring of Liabilities Cost Reduction Sale of Assets/Loan Portfolio Liquidity Improvement Recovery Reduction of RWA/Leverage Disposal Recovery Options Management Actions 	Back to 'Normality'
Market-wide (fast)	Impact		
Idio-syncratic (gradually, slow)	Impact		
Market-wide (gradually, slow)	Impact		
Combo – Idiosyncratic & market –wide (fast)	Impact		
Combo – Idiosyncratic & market – wide (gradually, slow)	Impact		

12 months

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Example: Recovery Options in Banking

Awareness of the logistics of execution and its impediments is crucial.

Capital Raising	Capital preservation	Restructuring of liabilities	Sale of asset/loan portfolio	Liquidity Improvement	Reduction of RWA/leverage	Disposal Recovery Options	Management Actions/Cost Reductions
<ul style="list-style-type: none"> ➢ Rights issue ➢ Ordinary capital increase ➢ Issue of mandatory convertible bond ➢ Issue of AT1 ➢ Issue of T2 ➢ Parent support ➢ Conversion of T2 capital into T1 capital ➢ Intra-group credit line 	<ul style="list-style-type: none"> ➢ No distribution of dividends to shareholders ➢ No payment of coupon on AT1/T2 issues ➢ Earnings retention 	<ul style="list-style-type: none"> ➢ Liability management transactions ➢ T2 instruments buyback ➢ Reduce the trading book ➢ Organic loan portfolio reduction 	<ul style="list-style-type: none"> ➢ Sales of leveraged loan portfolios ➢ Securitisation of portfolios ➢ Synthetic securitisation ➢ Asset sales – real estate 	<ul style="list-style-type: none"> ➢ Retained covered bonds ➢ Accessing central bank liquidity facilities with routine collateral ➢ Repo or pledge high-quality liquid assets ➢ Replace, sell, repo or swap non-high-quality liquid assets 	<ul style="list-style-type: none"> ➢ Unwind of portfolio management ➢ Unwind of fixed income financing ➢ Portfolio run-off ➢ Sale of strategic equity stakes ➢ Unwind of equity derivatives business 	<ul style="list-style-type: none"> ➢ Sale of business lines ➢ Sale of subsidiaries ➢ Sale of significant equity holdings 	<ul style="list-style-type: none"> ➢ Reduction in personnel ➢ Stop/delay IT investments ➢ Cancel bonus payment ➢ Reduction in working time ➢ Reduce lending ➢ Increase fee income

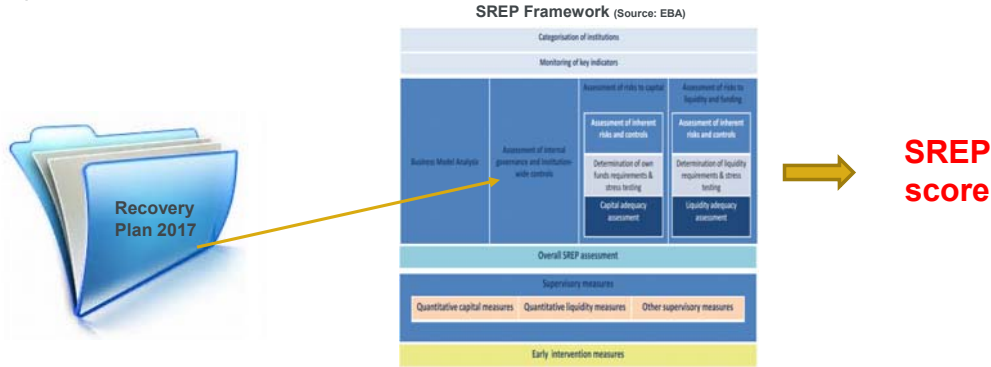
The selection of the appropriate option (s) depends on the severity and characteristics of the risk event, options may be combined in order to support the bank's return to the BAU status.

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Regulator assesses the Bank's Recovery Plan

Recovery plan is assessed under the Supervisory Review and Evaluation Process (SREP) and therefore impacts the Bank's SREP score.



Recovery Plans – Practical Experience

- Intended to be living documents which demonstrate that the recovery measures presented can be implemented in reality – and that is not an easy task (superficial plans are rejected, resubmissions are required)
- Interpretation of the regulations – potential inconsistency in regulatory requirements and possible national interests
- The length of recovery plans can span hundreds of pages, maintenance of plan, data and supporting analysis is a crucial requirement
- Must be achievable (practical) and capable of being put into action straight away (executed within 12 months)
- Idiosyncratic vs systemic situations or both
- Operational plans (levering with existing contingency planning) – arranging counterparties, setting up data rooms, line up investment banks etc.
- Consistency with ICAAP, Risk Appetite Statement and Stress Testing/Risk Management (existing Risk Management Framework)
- A number of iterations are required as regulator and company evolves expectations of plans
- Resolution plan not typically disclosed to the bank

Case Study: recent cases

Banco Popular Español S.A. (7 June 2017, Spain)

- Driven by a significant deterioration of bank's liquidity situation (€2bn withdrawn a day)
- Collapse primarily attributed to 'toxic' real estate loans on its books and its failure to raise fresh capital
- SRB assessed that resolution of bank is in the public interest and adopted resolution scheme
- Shareholders and junior bondholders have been wiped out

Veneto Banca & Banca Popolare di Vicenza (25 June 2017, Italy)

- Driven by bad loans and dragged down by a mis-selling scandal
- Decision a result of lack of capital (failed attempts to raise fresh capital)
- SRB concluded that conditions for a resolution action were not fulfilled
- Banks to be wound up under Italian insolvency procedures (a total cost of up to €17bn)

Questions

Comments

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