An initial list of Global Systemically Important Insurers (G-SIIs) has now been identified by the Financial Stability Board (FSB), in consultation with the International Association of Insurance Supervisors (IAIS) and national authorities. The list is currently limited to direct insurers, with reinsurers to be assessed for G-SII status by July 2014. The nine designated insurance groups are: Allianz, AIG, Generali, Aviva, AXA, MetLife, Ping An, Prudential Financial and Prudential plc*. While the full impact of this designation is not yet apparent, designated insurers will have to demonstrate their corporate agility and strength by setting out recovery actions designed to maintain their going concern status in the event of a severe stress situation. They will also need to set out the steps that regulators could take to resolve the institution with the minimum possible systemic disruption if the institution fails, despite the planned recovery actions.

To satisfy this obligation, the nine insurance groups designated have just 18 months to develop and agree with their Crisis Management Group (CMG) detailed recovery and resolution plans (RRPs) including liquidity risk management plans and 12 months to develop systemic risk management plans (SRMPs) for submission to their supervisors. Plans are likely to require board-level review and agreement, with widespread consideration of the insurer’s business model today and in the future.

Given the narrow timeline to develop group-wide plans and potential strategic implications, timely action is necessary to minimize the impact and ensure that the application of the policy measures is tailored to the group. This executive update is designed to set out the implications of a G-SII designation. It includes the fundamental considerations for recovery and resolution planning and systemic risk management planning, together with suggested actions for global and domestic insurers, many of whom are likely to be affected by this regulatory approach in time.

*On 18 July, the Financial Stability Board (FSB) identified an initial list of global systemically important insurers (G-SIIs). http://www.financialstabilityboard.org/
Implications of a G-SII designation

The insurers designated as G-SIIs are required to respond to the policy measures set out by the IAIS and summarized below. G-SIIs will be required to develop and submit detailed SRMPs and RRPs to their group-wide regulator (usually the home regulator) within 12 and 18 months respectively of designation. These are challenging time frames, particularly as the RRP needs also to be agreed by the supervisory crisis management group (CMG) to be established for each G-SII, before the 18-month deadline.

While most designated G-SIIs have waited for a formal request from their home regulator before mobilizing their RRP and SRMP program, some have already commenced initial scoping and planning to develop a suitable approach. This was to get ahead of the curve and reduce both the scale of the program and the potential impact of the G-SII designation.

Overview of the policy measures to be applied to G-SIIs

The policy measures now finalized and released by the IAIS are intended to:

- Reduce the impact and likelihood of distress or failure and the associated systemic effects that a disorderly failure could cause;
- Motivate G-SIIs to become less systemically important, and disincentivize groups that are not G-SIIs from becoming such; and
- Be tailored, in their implementation, to the factors that led to each individual group’s designation.

The table below outlines the key policy measures that will apply to G-SIIs. The measures fall into four categories: enhanced supervision, effective resolution, basic loss absorbency capacity for all group activities and higher loss absorption capacity for non-traditional and non-insurance (NTNI) activities.

<table>
<thead>
<tr>
<th>Policy measures</th>
<th>Description of policy measure</th>
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| Enhanced supervision             | ▶ Enhanced supervision will apply immediately to G-SIIs, based on the IAIS’ insurance core principles, its developing enhanced framework for internationally active insurance groups and the FSB’s supervisory intensity and effectiveness (SIE) recommendations.  
▶ A key role is envisaged for the group-wide supervisor, who will have a clear mandate for group-wide supervision and should focus on the unique risk profile of each G-SII and take into account the reasons for its designation.  
▶ Under the oversight of the group-wide supervisor, G-SIIs will be required to develop SRMPs by July 2014 and implement them within a further two years.  
▶ G-SIIs will be required by the group-wide supervisor to demonstrate the adequacy of their liquidity planning and management on a group-wide basis, by the end of 2014.  
▶ The group-wide supervisor may choose to require ring-fencing NTNI or reducing activities of particular systemic concern. It may also consider applying restrictions and prohibitions to manage systemic risk concerns. |
| Effective resolution             | ▶ The FSB provides recovery and resolution planning requirements under the “FSB Key Attributes of Effective Resolution Regimes for Financial Institutions”(FSB October 2011). Additional guidance was published by the FSB on 16 July 2013 on a) effective resolution strategies, b) critical functions and critical shared services, c) recovery triggers and scenarios. The IAIS policy measures are in line with the FSB recommendations:  
▶ Insurers’ supervisors will establish CMGs; subject the G-SIs to resolvability assessment; establish institution-specific cross-border cooperation agreements.  
▶ The identified G-SIs will be required to prepare and submit detailed RRPs, to be agreed by the CMGs, before the end of 2014.  
▶ The IAIS comments that effective resolution will need to take account of actions to separate NTNI activities, the availability of portfolio transfers and runoff schemes to resolve troubled entities, and the existence of guarantee funds in many countries.  
▶ The IAIS also intends to develop a template for assessing the resolvability of G-SIS to assist supervisors in identifying potential structural measures to facilitate resolution. |
| Loss absorbency capacity         | ▶ The IAIS acknowledges that a backstop capital requirement is needed, which will be applied to all group activities of G-SIs (including non-insurance subsidiaries) and will provide a foundation for the higher loss absorption capacity (HLA) to be applied to NTNI activities.  
▶ The new backstop capital requirements are to be finalized by the end of 2014. |
| Higher loss absorption capacity   | ▶ To reduce the likelihood of G-SIs failing – as well as to disincentivize activities that threaten the stability of the financial system – NTNI activities of G-SIIs will from January 2019 be subject to higher loss-absorption capacity requirements than other insurers, as an uplift to the backstop or other relevant capital requirement.  
▶ The extent of HLA requirements will depend on how effectively the NTNI have been separated from the G-SII’s other activities.  
▶ HLA capacity requirements must be represented by the highest quality of capital. |
Domestic significance

Recovery and resolution is not only an issue for G-SIIs; regulators have been assessing the need for recovery and resolution planning for insurers on the cusp of a G-SII designation and other large domestics too, particularly those with material international operations.

To date, the United States is furthest along in designating domestic systemically important financial institutions (SIFIs). The Financial Stability Oversight Council (FSOC) has assessed domestic insurers against: 1) whether distress at the insurer could pose a threat to US financial stability, and 2) whether the size, scale, scope, concentration, nature of business and interconnectedness could pose a similar threat. In early June 2013, FSOC designated AIG and Prudential Financial as SIFIs, and both will be subject to stricter supervisory oversight, which includes development and submission of an RRP to the state regulator and the Federal Reserve Bank.

The Netherlands and Canada have also required recovery planning from midsize to large domestic insurers and international insurers headquartered in their market. The Office of the Superintendent of Financial Institutions (OSFI), the Canadian insurance regulator, was one of the first to request recovery plans from the largest insurers headquartered in its market.

Other regulators, such as BaFin in Germany, the Prudential Regulation Authority in the UK and the Australian Prudential Regulation Authority, have also indicated that recovery and resolution planning will form part of their supervisory approach, and they too will require such planning from midsize to large domestic and international insurers headquartered in their markets, which potentially pose barriers to resolvability.

Given the current tempo, regional and national supervisors are likely to consider domestic designations over time, and large insurers that have not been designated as G-SIIs should expect to receive requests for recovery and resolution planning from their home regulators. We therefore recommend that large domestic insurers, particularly those with international operations, begin to prepare by undertaking high-level scoping of information that can be leveraged from existing initiatives and defining the program structure.

The implications of varying supervisory approaches to implementation

Regulators are expected to use broadly similar toolkits for recovery and resolution to assess resilience across the industry, with a degree of variation in terms of the level of detail required.

Some regulators have simply applied the banking recovery and resolution guidelines to insurers, recognizing that the FSB’s Key Attributes of Effective Resolution Regimes for Financial Institutions guidelines describe the requirements that should apply to all SIFIs, including G-SIIs. Other regulators to date have taken a risk-based approach and have focused on specific parts of the business, such as complex internal transactions, internal reinsurances and a small set of material entities that engage in NTNI or house-critical operations.

While there is a drive toward greater co-ordination through colleges of supervisors, the differing approaches taken by regulators will have an impact on the scale of effort required by insurers.

Additional contributing factors to jurisdictional differences include:

- The current lack of a global solvency standard: breach of capital and liquidity thresholds that trigger intervention and associated levels of reporting required could differ significantly across jurisdictions, and the subsequent level of supervisory intervention could also vary, both in nature and timing. The IAIS is tasked with developing backstop capital requirements to be applied to G-SIIs, to be completed by the end of 2014.

- Legal-entity structure: the typical subsidiary structure of most insurers, as opposed to a branch structure, means that host regulators will be key stakeholders, and there is a possibility that a host regulator with a well-capitalized subsidiary may have divergent interests from a home regulator of an undercapitalized group.

- Different accounting standards: beyond intervention points and regulatory capital requirements, a third factor to consider is the differences in accounting standards across jurisdictions and, therefore, the impact on the calculation of thresholds and valuation of recovery options.

Given the range of contributing factors and differing approaches to implementing recovery and resolution planning, we would suggest that insurers should take the initiative and start planning early to help shape the application of the guidelines to their specific circumstances and find the best solution for the group.
Fundamental considerations for recovery and resolution planning

Insurers should tread carefully in developing their approach to recovery and resolution planning as simply handing over vast swaths of data to the regulator will most likely risk high program costs and inefficient execution. Key to this important exercise is to take a targeted and proportionate approach, focusing on those areas of most relevance, while avoiding an unnecessary data gathering (and maintenance) exercise.

Most insurers will be able to leverage existing risk management practices to design components of the RRP and therefore focus the effort required, although the formal development of plans will remain a significant undertaking. Ensuring active dialogue with the regulators and a focus on a very limited number of scenarios will help insurers to develop a practical and cost-effective approach.

Insurers will need to determine appropriate assumptions, selection criteria and an effective governance structure early on in the process to make this program manageable. Key issues to consider will be:

» **Scope**
- Whether to develop a group plan or local plans
- Whether to undertake a plan at group level, including all material entities, or focus on isolated parts of the business that may present vulnerabilities
- Whether to manage the development of the plans on a centralized or decentralized basis
- How to manage home and host regulators' interests effectively and engender co-ordination across the college of supervisors
- How to balance the interests of home and overseas boards and policyholders
- Defining appropriate selection criteria for the core components of recovery: point of non viability, capital and liquidity thresholds and triggers, stress scenarios and recovery options
- Defining appropriate selection criteria for the core components of resolution planning: material legal entities, core business lines and critical operations, NTNI and vulnerabilities in the group

» **Approach**
- The appropriate number and type of stress scenarios that reflect the nature and scale of the business
- Existing risk management practices, e.g., existing reverse stress testing, the group’s Own Risk and Solvency Assessment (ORSA) where available, risk appetite framework, liquidity risk management, business continuity planning and governance for decision-making in a crisis
- In-house restructuring and run-off activities to demonstrate the ongoing successful application of recovery tools
- Above all, how to design a program that is fit for purpose and reflects the actual underlying risks of the group and its business model

Ultimately, the time and level of detail required to complete this work should not be underestimated. G-SIIs should be preparing now to identify the team needed to respond to the designations, and, similarly, large insurers should be preparing for regulator requests.

RRPs will become a routine component of each G-SII’s regulatory and risk framework, and therefore decisions made today on plan, scope, depth and approach are likely to be longstanding.
Fundamental considerations for systemic risk management planning

G-SII designated insurers will need to review their systemic risk management and engagement with supervisors on their application of the policy measures. Like RRPs, SRMPs are to become a routine aspect of regulation for G-SIIs.

Some G-SIIs may be successful in managing their systemic risk through restructuring and other measures, such as improving liquidity planning and governance. Insurers will need to assess the extent to which existing structures and risk management achieve the objectives set out in the policy measures.

Key issues to consider include:

- How to develop appropriate selection criteria to define and measure NTNI activities for the group, including nature of risk and materiality (within the boundaries of the principles provided by the IAIS for definition)
- Whether current liquidity risk management addresses and measures liquidity at group level and entity level for entities that write NTNI (in both normal and stress conditions)
- Whether current liquidity levels and capital are adequate under the current structure
- How to leverage existing metrics or develop metrics that provide appropriate visibility of liquidity, segmented between traditional insurance activities and NTNI
- Whether additional options are required to improve liquidity management and systemic risk management
- How to determine proportionate options and mechanisms to manage systemic risk effectively for example, through ring-fencing, ensuring that entities with NTNI are self-sufficient and properly capitalized, reducing NTNI activities, or holding better quality debt capital
- How to determine the costs and benefits of effective separation of NTNI, in terms of loss of synergies and the impact on HLA
Resource implications

Failure to plan and demonstrate that mechanisms are in place to address perceived vulnerabilities could be costly, potentially resulting in a higher level of supervisory intervention, higher effective capital requirements (higher loss absorption capacity) or ex-ante structural change in the most extreme circumstances.

Recovery and resolution planning and systemic risk management planning are far from trivial exercises, not least given the complexity of insurance regimes in many countries and the degree of connectivity in some insurance groups. If insurers are to manage the scope of RRPs and SRMPs in proportion to their business model, they will need to allocate a focused central team, sponsored directly by executive stakeholders and given adequate time to develop plans and position strategic messaging appropriately.

Some insurers are working on the basis that the detailed supervisory approach for insurers will not differ widely from that developed for banks and are planning a tailored approach accordingly. Erring on the side of caution — in the context of recovery and resolution planning — means developing an iterative bespoke approach that minimizes the scale and effort required and demonstrates a credible solution to the regulator.

If developed early enough, insurers have a chance to influence the home regulator on interpretation and application of the policy measures. An alternative approach is to wait for the interpretation of the policy measures to stabilize, and begin planning towards the end of Q3 this year.

Short-term practical actions

We have set out a series of suggested actions for insurers to address the challenges imposed by recovery and resolution planning:

- Agree a board sponsor and establish a steering committee, senior working group and design authority: executive management should be engaged early on to agree to strategy — its involvement will also help ensure the right resources are available for the project.
- Establish program structure: robust governance will be required to ensure an efficient program.
- Determine appropriate allocation of resources and resource mix: recovery planning requires a small central team with input from other functions — resolution can be broader depending on agreed-upon scope.
- Engage with the home regulator.
- Develop a well-defined communications plan: agree internal communications to key stakeholders and external communications to the market.
- Self-assess group recovery strength, systemic risk and resolvability.
- Self-assess ability to maintain critical operations in a severe crisis.
- Scope relevant data and information sources for recovery, resolution and systemic risk management — include information on group legal-entity structure, intra-group exposures, service-level agreements, outsourcing arrangements, IT services and infrastructure.
- Determine how existing risk management practices can be leveraged.
- Define key assumptions for recovery and resolution.
- Define legal entities in scope and map critical operations and core business lines to material legal entities on a prioritized basis.
- Clearly define high-level scope and approach. In order to contain the program — it is important to define the end product and be able to articulate the basis of the scope, approach and deliverable clearly to the home regulator at the outset.
Broader implications of a G-SII status

In addition to developing a tailored approach to respond to the policy measures, senior stakeholders in the group should give consideration to the potential SIFI effect. Implications to be considered include:

- The impact on the cost of capital: it seems probable that a G-SII status might enable a group to obtain a lower cost of capital by virtue of a perceived improvement in creditworthiness.

- Competitive advantage: it is possible that the HLA impact will be small and it could well be outweighed by the ability to take market share, based on being branded as “too big to fail.”

- Reduced diversification benefits: requirements to separate NTNI from traditional insurance business and additional capital buffers could reduce diversification benefits and therefore increase overall group capital requirements.

- The impact on local capital requirements: the possible need for localized capital means that capital may be locked into subsidiaries, which could result in reduced diversification benefits, capital inefficiency and a slight reduction in returns.

- Capital optimization: prospective strategic disposals, acquisitions, balance sheet de-risking, or balance sheet optimization are likely to be viewed through an “RRP lens” by most regulators.

- Increased operational costs: G-SIIs will face additional reporting requirements, and the regulatory scrutiny for executives and boards is likely to mean increased operational costs.
How EY can help

EY has already assisted global insurers in the development of RRPs, including submissions to the regulator. We are currently working with leading industry insurers to develop RRPs and are supporting a number of others with their initial planning.

We have established leading expertise on RRPs and systemic risk management across the financial services sector in recent years. We have worked with 14 of the original 29 banks designated as global-SIFIs to help them develop robust RRPs and bring deep, practical insights as to how to manage the development of RRPs across multiple jurisdictions in a cost-effective manner.

Our globally connected teams tailor our services to diverse requirements, and we can support insurers’ planning in the following ways:

1. **Program launch, development of scope and approach**
   
   We assist by helping insurers plan the activity required and design the work streams and the governance structures for the program. A small senior central team is essential. Integral to this phase is assessing the key areas of regulatory focus – we will help you target the scope so that it is manageable, assessing how to minimize the effort and impact of the guidelines on your group while producing a high-quality output.

2. **Recovery and resolution analysis and systemic risk management analysis**
   
   We provide technical resources to assist your teams with the analysis, particularly the definition of legal entities and business activities in scope, development or enhancement of stress scenarios, gap analysis against existing risk management practices, selection of credible material options, validation of options, scenario analysis, feasibility assessments and identification of impediments.

3. **Formal plan preparation**
   
   We can help you to develop and draft an integrated set of plans (recovery, resolution and systemic risk management) across multiple jurisdictions by aggregating the data and interpreting the results, and by recommending consistent and coherent messaging for regulators. Our proven approach and existing templates accelerate your program and reduce compliance costs.

4. **Program management or independent quality assurance**
   
   We can help you to drive implementation pace and results, help you run the overall program and provide you with robust program management assistance so you can deliver rigorous plans. We can provide you with assurance on your process, methodology, models, assumptions and results. An experienced external perspective will strengthen the objectivity applied to your plans.

5. **Deliver sustainable plans and benefits**
   
   We help develop a sustainable RRP and SRMP structure and documentation style, leveraging existing data sources and technology to manage ongoing support and maintenance. You benefit from our experience with global firms, not just in the delivery of initial plans, but the direct practical insights from embedding RRPs into the fabric of firms, limiting the time and cost of plan refreshes while gaining real business benefit from the investment.
Conclusion

Corporate agility and strength to enable survival in the event of severe crisis can be enhanced through robust recovery and resolution planning and systemic risk management. Insurers, no doubt, have a strong foundation of existing risk practices that can be leveraged to support this. Few would argue that this is an exercise that must be initiated from scratch.

As insurers formalize their approach to dealing with this challenge, the key issue will be to develop a proportionate, pragmatic approach and design a program that reflects the actual underlying risks of the group and its business model.

It is encouraging that the now largely finalized IAIS policy measures (further guidance on HLA policy measures is expected in 2015) explicitly acknowledge the need for implementation to be linked to the drivers of each individual insurer’s G-SII status. Less encouragingly, the time frames have shortened; the SRMP must now be completed within 12 months, and the 18 month period allowed for the RRP and liquidity management plans needs to include time for their agreement by the CMG.

The time to complete these actions should not be underestimated, and we recommend that the insurers in these categories should begin to prepare.
Contacts
For further information about how our team can help you, please speak with your usual EY contact or the individuals named below.

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10  | Recovery & resolution planning and systemic risk management planning for insurers  July 2013
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