

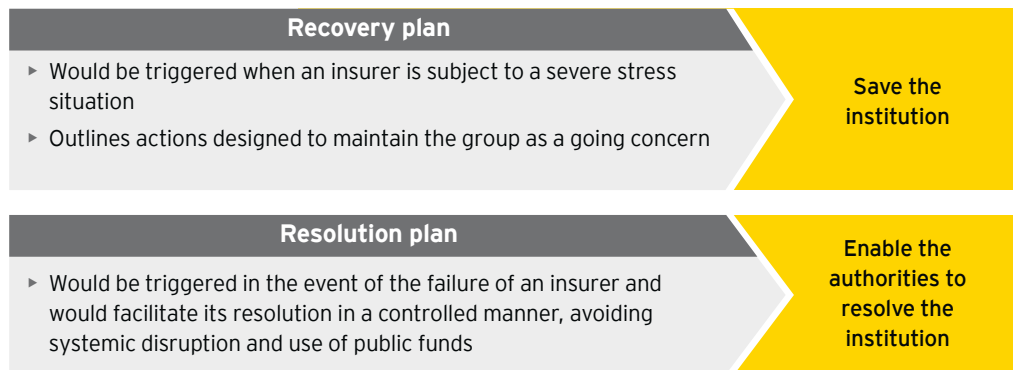
# Senior Executive Update

## Recovery and resolution planning

### The spotlight moves onto insurers

In the wake of the global financial crisis of 2008, regulators recognized that there was an urgent need to address firms being “too big to fail.” Regulators believe that if government financial assistance may be necessary to support institutions under extreme stress, then they should have a stronger ability to influence the reorganization and recovery of such groups.

Recovery and resolution planning is therefore being introduced so that governments may avoid having to bail out systemically important financial institutions in a crisis. The plans are essentially blueprints for emergency actions to be taken in case of severe distress and, if necessary, to enable an institution to be liquidated in a way that limits the impact on retail customers and the global financial system.



After a long, hard period of scrutiny of banks, regulators are now turning to insurers. The International Association of Insurance Supervisors (IAIS) will shortly deliver a list of global systemically important insurers (G-SIIs) to the Financial Stability Board (FSB), which will be published by the end of June 2013. The G-SIIs will be required to submit detailed recovery and resolution plans and systemic risk reduction plans. This short update offers a high-level summary of the key things all insurers need to know and highlights what actions may be required.

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## Scope and timing

At a global level, the IAIS, under the tight remit of the FSB and the watchful gaze of the G20, is now assessing 48 insurers for systemic risk across five key factors: size, global activity, interconnectedness with the financial markets, ease of substitutability of cover, and non-traditional and non-insurance activity. While those being targeted in this first round of designations (more rounds will follow) may already know who they are, companies that are planning their responses need to formalize these plans, and those who have not yet begun to plan need to do so right away.

Once the June designation is announced, insurers will have 18 months to develop and complete a recovery plan, a resolution plan and a systemic risk reduction plan. This will be challenging for most. If the equivalent banking timetable is anything to go by, the insurance recovery and resolution planning timetable is likely to remain fixed. Implementation of the systemic risk reduction plan will be expected in the following 18 months and could include restructuring, improvement of liquidity planning, and improved governance – some insurers are already considering ring-fencing areas of the business, which may be deemed by the regulator as generating systemic risk.

The insurance industry's reaction to recovery and resolution planning is mixed: while some object to the prospect of yet more regulatory pressure and continue to lobby against global systemically important financial institution (G-SIFI) designation, others recognize that the global reach, size and level of diversification they enjoy are contributory factors toward a more cautious approach. Some insurers can see that recovery and resolution plans are perceived as a good thing for the market and that there are obvious strategic opportunities to position their products as recovery solutions. In addition, many insurers can build on the preparation work they have already undertaken for a series of other initiatives, notably Solvency II. Whatever an insurer's opinion, those who think there's a reasonable chance they'll be designated as G-SIFIs are gearing up and designing programs to prepare ahead of the June announcement of the first cohort of G-SII designation.



## Overview of the measures

The table below outlines the key policy measures the IAIS is proposing for G-SIIs. Although the measures are under consultation, we do not anticipate any material changes. The measures fall into three categories: enhanced supervision, effective resolution and higher loss absorption capacity.

Policy measure	Description of policy measure
<b>Enhanced supervision</b>	<ul style="list-style-type: none"> <li>▶ As an international standard-setter, the IAIS has already established insurance core principles and is developing an enhanced framework for internationally active insurance groups. The FSB's supervisory intensity and effectiveness recommendations would form an overlay for G-SIIs.</li> <li>▶ A key role is envisaged for the group supervisor, who would have primary responsibility for assessing the extent of non-traditional and non-insurance activities (NTNIs) and other systemic issues in the group.</li> <li>▶ G-SIIs will be required by the supervisors to demonstrate the adequacy of their liquidity planning and management within 18 months of designation.</li> <li>▶ G-SIIs will be required to develop systemic risk reduction plans within 18 months of designation and implement within a further 18 months.</li> <li>▶ Systemic risk reduction actions might include ring-fencing NTNIs or reducing activities of particular systemic concern. It is possible that implementing such actions might take an insurer out of the G-SII classification altogether. Supervisors will assess the level of implementation to determine the level of higher loss absorbency (HLA) capital required. The HLA will not be applied, however, until 2019.</li> </ul>
<b>Effective resolution</b>	<ul style="list-style-type: none"> <li>▶ The FSB provides a standard for key attributes of resolution regimes, and the IAIS proposes to apply this.</li> <li>▶ The identified G-SIIs will be required to submit detailed recovery and resolution plans.</li> <li>▶ Their supervisors will establish crisis management groups.</li> <li>▶ Their supervisors will subject the G-SIIs to resolvability assessment.</li> <li>▶ Their supervisors will establish institution-specific cross-border cooperation agreements.</li> <li>▶ Noting the different nature of insurance, 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.</li> </ul>
<b>Higher loss absorption capacity</b>	<ul style="list-style-type: none"> <li>▶ To reduce the likelihood of G-SIIs failing – as well as to encourage insurers to reduce their systemically relevant activities – the IAIS proposes that G-SIIs be required to have higher loss absorption capacity than other insurers (capital add-ons or other mechanisms).</li> <li>▶ The IAIS proposes a targeted approach, with the requirements applied where possible in those entities where the systemic risk is identified, but with a group-wide assessment to determine whether further measures need to be applied at the group level.</li> </ul>

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## European and national approaches

As the global players are poised to launch their programs, it is worth considering the impact at a European level and a national level. The European Commission is currently consulting on its approach to systemic risk in non-banking financial institutions including insurance, and national policy makers are also paying greater attention to this area. For example, in Canada, the Office of the Superintendent of Financial Institutions (OSFI) has already begun requesting recovery plans from select insurance companies. OSFI is expected to require resolution plans in the near future. Furthermore, insurance companies that are bank holding companies or have assets over US\$50b or in the US are likely to be required to produce recovery and resolution plans.

In the UK, the reach of the Bank of England is also growing, as it will soon gain further powers for preserving financial stability in addition to its monetary policy remit: the planned approach for the Prudential Regulation Authority (PRA), an agency of the Bank of England, envisages measures that address perceived systemic exposures in insurance, as in other sectors. The PRA has proposed a categorization of insurers based on scale, with greater scrutiny to be applied to the insurers that would cause most disruption to the UK financial system if they were to fail. The PRA has included liquidity and resolvability as a focus of its supervision. It has also highlighted a proactive intervention framework, including specific recovery and resolution actions that will be required as an insurer's perceived risk level and proximity to failure increases. This implies that, even if an insurer is not caught by a G-SII designation, regional or national supervision still means it needs to contemplate its own failure. Insurers need to build on stress and scenario testing in place and refresh existing recovery options. These options may need to be more robust, have risks and dependencies clearly identified, and have in place a well-defined decision-making process to implement the options. Regulators are likely to require evidence of credible planning covering core business units and jurisdictions.

## Practical challenges

Developing a consolidated approach that addresses global, regional and national systemic risks means that the combined impact on insurers will be substantial.

However, supervisors also face a big challenge. To date, the operation of supervisory colleges has been of varying effectiveness, but supervision of G-SIIs will place a new onus on supervisors to act together. In a world still based substantially on state regulation and a few regional regulatory frameworks, the new focus on international systemic risk represents a significant expansion of the supervisory role, but it is one that the G20 and the FSB consider crucial.

A key issue is to align national and regional approaches to systemic risk with this global initiative, so that regulators do not pursue competing goals. It is in the interests of insurers to achieve alignment of their core regulators in order to minimize the effort required to create recovery and resolution plans. G-SIIs that take the initiative in presenting clearly articulated plans integrated at the country, regional and global levels are more likely to be able to contain the level of resources and effort required and minimize duplication in different jurisdictions.

One of the key themes insurers will need to emphasize in their plans and dialogue with regulators is that the drivers of systemic risk for insurers are different from those of banks, and therefore insurers' options are also different. No one is disputing that insurers have longer liquidity than banks. Insurers need to invest time in communicating clear messages to the regulator to agree to an appropriate scope of the plan in order to minimize the level of effort required.

Moreover, experience in the banking sector suggests that systemic risk reduction and recovery and resolution planning will sometimes require extensive rethinking of the business and operating model. This may affect legal entity structures, product composition, use of shared resources (e.g., staff, systems and data), and intra-group financing and reinsurance arrangements, with significant business, operational, legal and tax implications.

Work that insurers have completed for programs such as Solvency II preparation and enterprise risk management (ERM) provides a good foundation for recovery and resolution planning. Nevertheless, the exercise is far from trivial, not least given the complexity of insurance regimes in many countries and the degree of interconnectedness in some insurance groups. Banks have found that recovery and resolution planning requires the involvement of many specialist skills and needs sponsorship from the top. This is hard to achieve when many countries are experiencing evolution in their insurance regulation. In Europe, in particular, the implementation of Solvency II will still require considerable effort in the coming years, creating potential competing resource requirements. However, the greater risk would be to not engage with the process on a timely basis and at a sufficiently high level.

## How EY can help

Our firms have been working with 13 of the 27 banks that have been designated as G-SIFIs to help them develop robust recovery and resolution plans and reduce the effort required in their preparation. We have also supported one of the very first global insurers in developing and submitting its recovery plan and are helping a number of insurers with their initial planning.

Our globally connected teams can provide firms with insights across multiple jurisdictions and can tailor our services to very diverse requirements. We can support insurers' planning in the following ways:

### 1. Program launch, data collection and assessment

We can assist by helping to plan the activity required and the governance structure for the project. A small senior central team is essential. We can also help you assess key areas of regulatory focus, map critical operations and assess interdependencies.

### 2. Recovery and resolution analysis and systemic risk reduction analysis

We can provide technical resources to assist your teams with the analysis, particularly the impact of reverse stress tests, selection of credible material options, validation of options, scenario analysis, feasibility assessments and identification of impediments.

### 3. Formal plan preparation

We can help you develop an integrated set of plans (recovery, resolution and systemic risk reduction) across multiple jurisdictions by aggregating the data and interpreting the results, and by recommending a consistent and coherent messaging for the home and core regulators.

### 4. Program management or independent quality assurance

We can help you 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.

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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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