



Recovery & Resolution Plans (RRPs) – International Developments in Insurance Regulation

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RE-CAP: FINANCIAL STABILITY DEBATE



What is the rationale for reform?

G20 objectives following the financial crisis:

- Ensure “the financial soundness of systemically important institutions” and
- Establish a regulatory framework for all SIFIs, instruments, and markets...

The FSB is responsible for delivering against these goals.



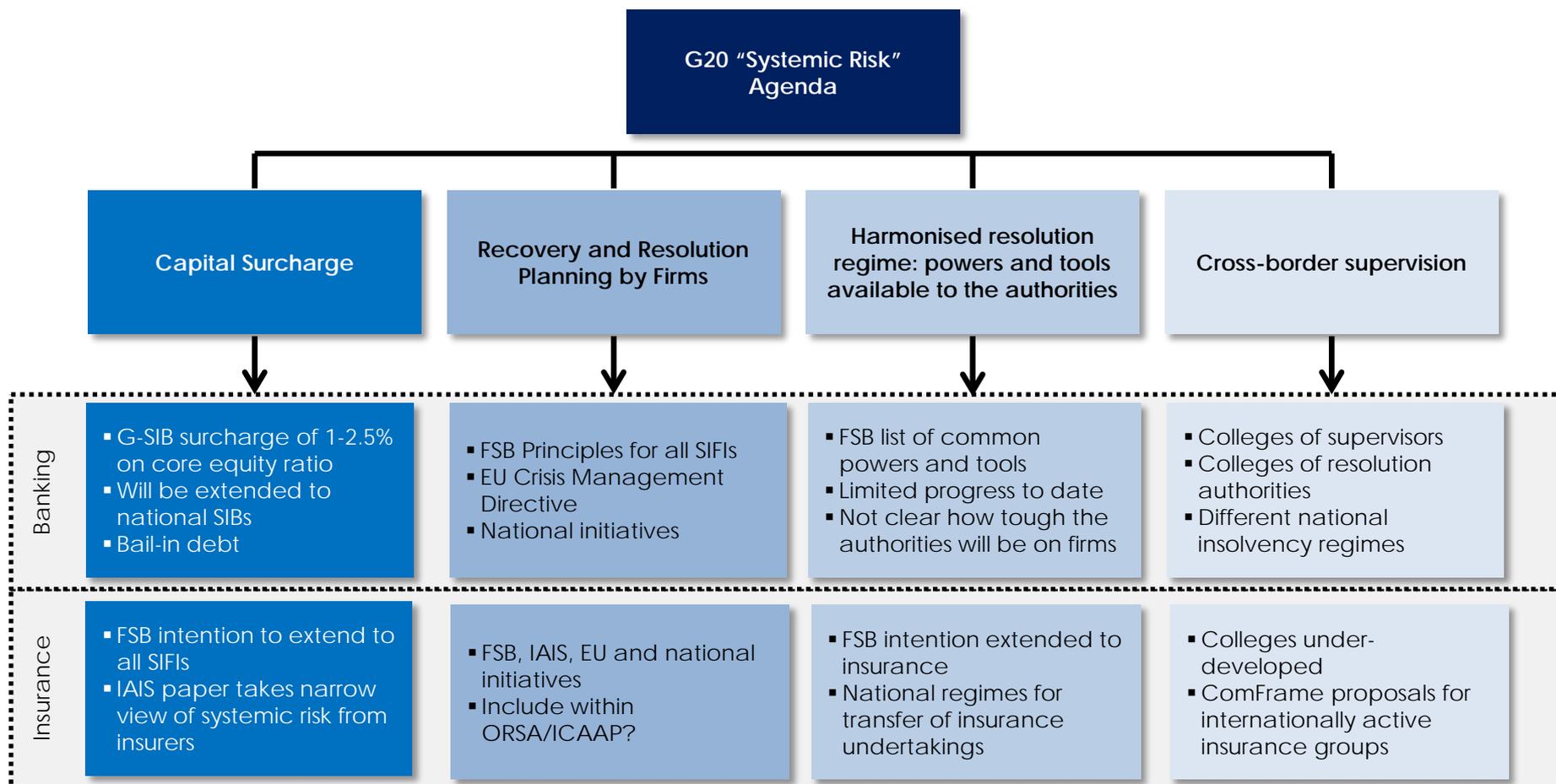
FSB Objectives

Mandate from the G20...

- FSB asked the International Association of Insurance Supervisors (IAIS) to provide input September 2011 into its deliberations concerning “the differentiated nature of regulation” and to recommend improvements for the sector.
- SIFIs required to put in place resolution plans to ensure that, if necessary, the SIFI could be restructured rapidly and smoothly in ways that:
 - a) preserve critical economic functions;
 - b) minimise the contagion risk to other financial institutions, and the economy more generally;
 - c) allow some or all of the SIFI’s business to be sold or otherwise transferred in an orderly manner;
 - d) enable these three outcomes to be achieved with the lowest possible cost to taxpayers.



BUT, are Insurers Systemically Important?





BUT, are Insurers Systemically Important?

Systemic Risk in the Insurance Sector

- Many in the sector are still convinced that insurance firms do not pose systemic risk to either a national or global economy.

SIFIs and RRP

- Debate still in focus concerning the extent of resolution analysis required vis-a-vis recovery.

Enhancement of Group-wide Supervision

- Considerable discussions now occurring regarding appropriate mechanisms that should be established to limit future risks to the real economy arising from group-wide activities.

New ComFrame proposal

- International supervisors now actively developing a global framework for the setting of capital for IAIGs. Still unclear the impact on existing local requirements.

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IAIS/FSB FRAMEWORK FOR G-SIIS



IAIS/FSB framework for G-SIIs

Overview of relevant regulatory guidance

Below overview sets out the relevant regulatory guidance issued to date, including an indication of their relevance for RRP and the broader resolution policy measures of authorities.

Date	Regulatory guidance document	Relevance	
		RRP	Resolvability
4 Nov 2011	FSB, “<u>Key Attributes</u> of Effective Resolution Regimes for Financial Institutions” Describes key components of effective resolution regimes for implementation by home and host authorities	Chapt. 11	Chapt. 4 to 10
16 July 2013	FSB, “Guidance on identification of critical functions and critical shared services” Assists home and host authorities in meeting the recovery and resolution planning requirements under the FSB Key Attributes in relation to systemic banks	Chapt. 2	Chapt. 3
18 July 2013	FSB, Initial list of global systemically important insurers (G-SIIs)	-	All
18 July 2013	IAIS, “Global Systemically Important Insurers: Policy Measures” Guidance for authorities for the implementation of resolution regimes and outline of the methodology which was applied for the initial designation of insurers whose distress or disorderly failure, because of their size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity;	Chapt. 3.2, 3.3	Chapt. 3
12 August 2013	FSB, “Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions” (<u>Consultation</u> only, not yet formally enacted) Assists jurisdictions and authorities in implementing the Key Attributes with respect to resolution regimes for Financial Market Infrastructure, insurers and firms with holdings of assets	Appendix II	Appendix II



IAIS/FSB framework for G-SIIs Globally Systemically Important Insurers (G-SII) designated

- Initial list of G-SIIs:

Allianz	AIG	Generali
Aviva	Axa	MetLife
Ping An (China)	Prudential (US)	Prudential (UK)

- Reinsurers deferred for 12 months for deeper review on substitutability and interconnectedness – decision expected this July
- FSB July 2013 guidance outlines FSB/supervisory expectations – IAIS has modified approach for insurers
- Note that supervisors involvement expected across all G-SII designated groups as part of the Supervisory College process
- Expectation that G-SII requirements will be extended to D-SIIs



IAIS/FSB framework for G-SIIs

IAIS policy measures

IAIS policy measures are based on FSB principles as applicable for banks, and have been developed to account for specific non-bank risks the insurance industry may pose to the financial system.

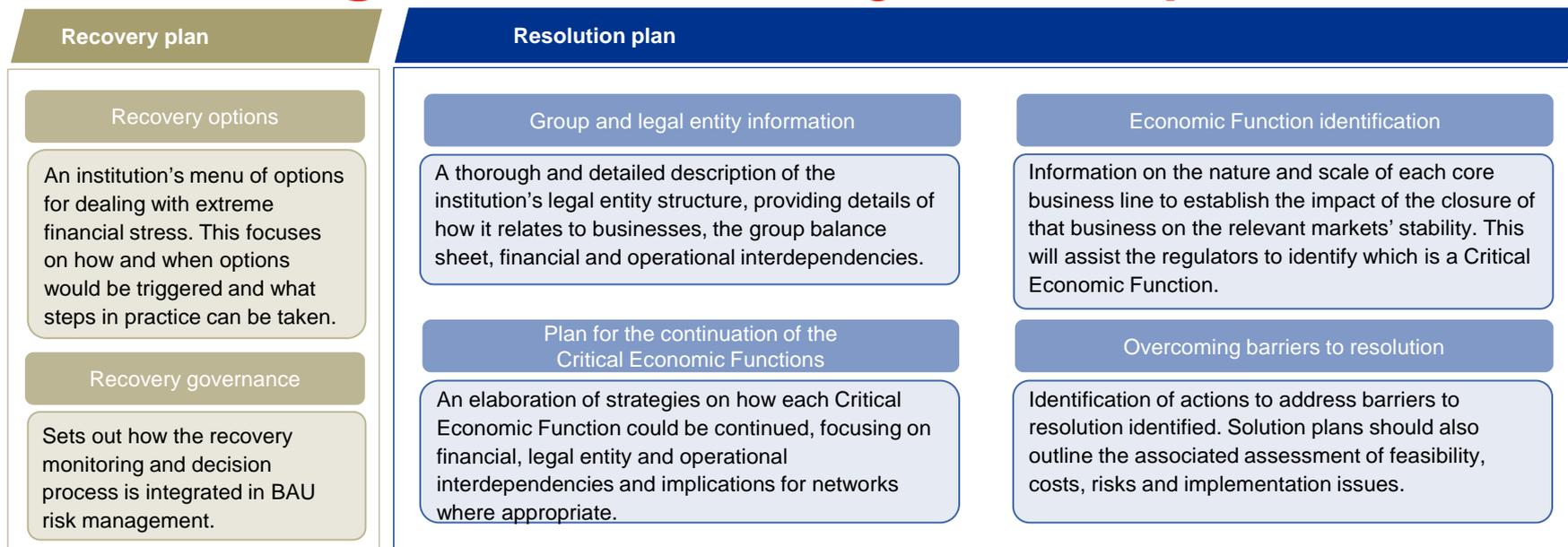
The key principles promoted by IAIS are as follows:

- Authorities to comply with FSB's Key Attributes for Effective Resolution
- Establish a Crisis Management Group (CMG)
- Elaborate RRP
- Carry out resolvability assessments (incl. effective separation of NTNIA); IAIS to develop a template for assessing resolvability
- Adopt institution-specific, cross-border cooperation agreements
- Broad range of tools to be available to authorities: e.g. solvency plan if SCR breached; financing plan if MCR breached...
- Effective resolution to take account of insurance specificities:
 - Plans and steps to separate NTNIA
 - Possible use of portfolio transfer and cross-off arrangements
 - Existence of policyholder protection and guarantee schemes



IAIS/FSB framework for G-SIIs

Core components of an RRP that regulators will likely focus upon



Summary component

Evidences how the overall RRP analysis process has been conducted. Also sets out the governance over the RRP process and contains a summary of the issues and correcting actions the group has identified to improve its recoverability and resolvability, serving as a key regulatory dialogue tool.



IAIS/FSB framework for G-SIIs Resolution plan and the Systemic Risk Management Plan (SRMP) (1/2)

One of the IAIS' key requirements is that the group-wide supervisors should also analyze activities that cause systemic importance of G-SIIs and take necessary measures to reduce that systemic importance. This includes overseeing the development and implementation of a SRMP which could include measures such as separation of NTNI activities from traditional insurance business and/or restriction or prohibition of systemically important NTNI activities.

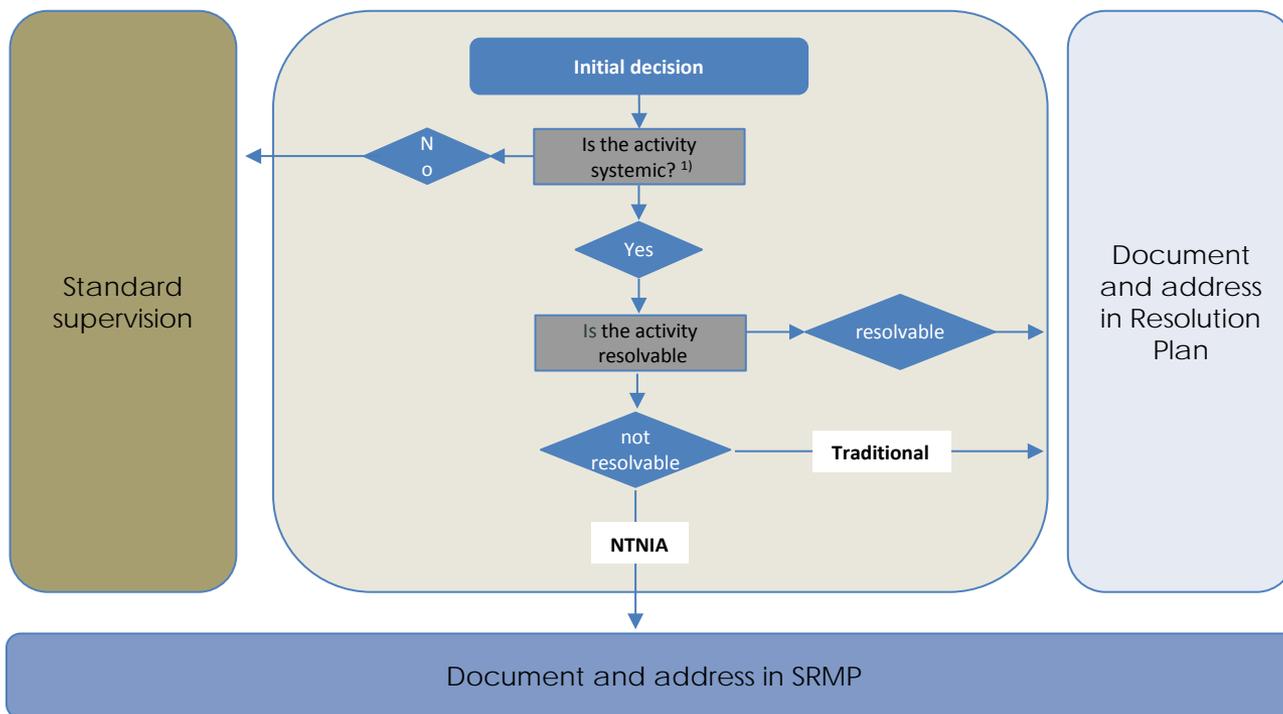
The SRMP and the Resolution plan are two separate tools with distinguishing features as set out below:

Resolution plan	SRMP
Represents a scheme for maintaining the Group's essential and systemically important economic functions during Resolution	Describes how to manage, mitigate and possibly reduce systemic risk
Addresses traditional insurance services provided to third parties	Addresses the risks identified in the regulators' decision to designate an insurance group as a G-SII (NTINA and interconnectedness with financial market)
Executed at decision of the regulators if Group is not viable any more or approaches point of non viability	Executed at decision of management during normal course of business (going concern), under the oversight of the regulators
Owned by regulators	Owned by management
Potential impact on Group due to: <ul style="list-style-type: none"> ex-ante mitigation of barriers to resolution preparatory measures which enable execution of resolution strategies set-up of bridge institution (fall back in case that resolution strategies fail, if requested by regulator) 	Potential impact on Group given that required measures focus on ex-ante reducing systemic risks or mitigating those risks (e.g. through the use of additional capital so as to internalise at least some of the cost of the externalities that arise from such risk taking)



IAIS/FSB framework for G-SIIs Resolution plan and Systemic Risk Management Plan (SRMP) (2/2)

A strategic analysis of the Economic Functions will be required in order to identify Critical Economic Functions and how to address them:



1) The initial decision on systemic relevance will be based on the home and host authorities requirements, and may need to initially be conducted with self-developed criteria, given FSB guidance currently focuses on banking groups.



IAIS/FSB framework for G-SIIs NTNIA principles according to IAIS

The policy measures requested by IAIS have a strong focus on NTNIA, given IAIS weighted NTNIA with 45% when assessing the 5 risk categories for the purpose of initial G-SII designation.

The IAIS set out the following principles to adopt for identifying NTNIA activities which will be relevant for to SRMP.

Principle 1

Products that provide credit guarantees to financial products such as securities, mortgages and other traded or non-traded instruments – whether principal or interest – can be considered NTNIA.

Principle 2

Policies or products that expose the insurer to substantial market and liquidity risk and require a more complex risk management practice by the insurer in order to hedge those risks and may require substantial, complex, and dynamic use of derivatives, can be considered NTNIA.

Principle 3

Investment and funding or other capital market activities that result in maturity or liquidity transformation, leverage or imperfect transfer of credit risk, such as repo and securities lending, beyond that justified by the scope and scale of conducting traditional insurance activities, can be considered NTNIA.



IAIS/FSB framework for G-SIIs

Classification of insurance activities

Traditional

- Non-Life (P&C plus Health, Disability)
- Non-Life: Long-tail (they involve some interest rate risk, but are still predominantly non-financial)
- Life – Term – Fixed Death Benefits, Fixed Premium
- Life – Term – Variable Benefit, Variable Premium (investment return risk borne by policyholder)
- Life – Whole life with fixed death benefits (implicit fixed accumulation rate)
- Life – Whole Life with variable account value (includes risk of investment returns)
- Life – Whole Life with some minimum accumulation rate or minimum death benefit
- Annuity with Fixed Rate of Return
- Annuity with Variable rate of return (insurer bears longevity risk, policy holder the investment returns)
- Variable Accumulation, Fixed Payout
- Insurance-linked securities (ILS), e.g. Cat Bonds and other forms
- Short-term trade credit insurance

Non-Traditional

- Annuities: Variable Annuities – GMIB (fixed accumulation returns)
- Guaranteed minimum death benefit (GMDB) or Guaranteed minimum annuitisation rate
- Guaranteed Minimum Withdrawal Benefit (GMWB)
- Contingent Deferred Annuity (some longevity risk, mostly market return risk)
- Unit-linked accounts with guaranteed account value or non-negative returns (some longevity risk, mostly a financial guarantee)
- Guaranteed Investment Contracts (GICs)
- Synthetic GIC (insurer bears market value/return risk)
- Mortgage Insurance (credit guarantee)
- Credit Guarantees – municipal debt, structured credit products, (pure credit guarantee)
- Financing or monetizing ILS, e.g. Embedded Value/Present Value of Future Profit securitisations, ILS with financial risk as material trigger condition.



WHAT THESE REQUIREMENTS MEAN IN PRACTICE FOR A G-SII/D-SII

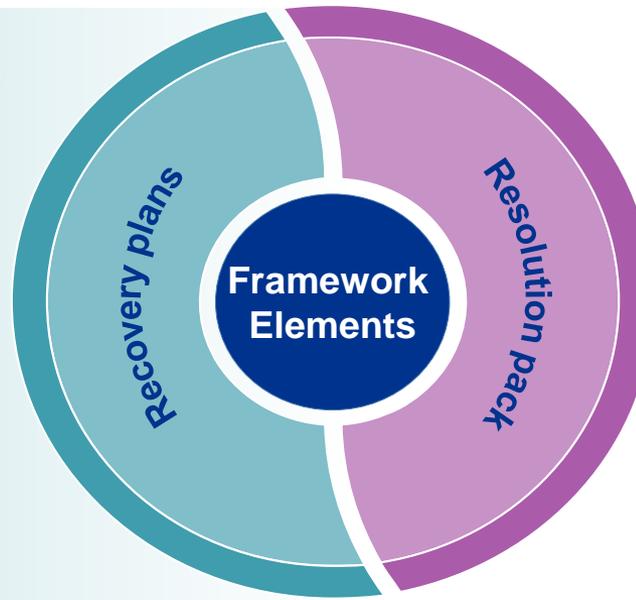


How a G-SII/D-SII may be impacted

Greater transparency is the basis for regulatory action

Key supervisory requirements to

- Identify options to recover financial strength and viability under severe stress.
- Identify potential impact on the group structure and its ability to recover from loss event (at group and solo level) and in case of gone concern, its impact on resolution.
- Undertake analysis of critical economic functions, particularly the impact of any NTNI business.
- Extend the current processes for managing capital and liquidity under stress.
- Demonstrate that the business model and risk appetite is capable of incorporating a 'Plan B'.
- Provide for additional governance arrangements across the group.



Operating model: Key scope areas

- Effectiveness of strategic planning processes that incorporate resolvability perspectives.
- Interconnectedness of a G-SIIs/D-SIIs operations on the broader financial services sector and consumers.
- The financial and operational dependencies between:
 - Significant legal entities;
 - Critical insurance products and services; and
 - Intra-group transactions and cash-flow dependencies

G-SII's/D-SII's will be expected to achieve greater transparency with respect to the business model, increase regulatory acceptance and provide a tool for regulatory communication

- The right RRP programme should allow a G-SII /D-SII to demonstrate the effectiveness of its current risk management capabilities and augment, where necessary, additional recovery optionality and resolution analysis via further identification and ability to remove any structural, financial and operational dependencies that may prevent key legal entities and/or critical products/services being separated from the rest of the organisation, where required.
- Demonstrating Board and Senior Management involvement and understanding of the RRP plan will be fundamental in ensuring continued good governance, commercial and regulatory acceptance.



How G-SIIs/D-SIIs may be impacted What is the likely effect on the business activities?

- The IAIS is concerned about the continued systemic risk and rising macro-financial linkages between insurance activities and the financial sector
- The IAIS' primary objective is to require G-SIIs to reduce or ring-fence the NTNIA activities – likelihood of higher capital charges for systemic NTNIA otherwise
- G-SIIs are required to complete a Systemic Risk Management Plan by June 2014, addressing their systemic risks
- The IAIS concluded that traditional insurance business is not systemic; as such, whilst the IAIS confirmed that FSB rules on recovery and resolution planning (RRP) also apply to G-SII, these will effectively be relevant to a minor extent when compared to banks, as their focus is the continuation of systemic activities (Critical Economic Functions)
- Critical Economic Functions are activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for the financial stability
- G-SIIs analysis of Critical Economic Functions in accordance with FSB rules will need to provide evidence that failure of the G-SII would not lead to the disruption of insurance services, nor contagion through losses from NTNIA exposures
- Highly likely APRA will apply similar expectations to large domestic insurance groups



How G-SIIs/D-SIIs may be impacted What is the likely effect on the organisation?

The development of the initial Resolution plan may require a formal project organisation and the involvement of various functions. Mid and longer term effects may arise from the implementation of measures to remove barriers to resolution and on the basis of the SRMP.

Area	Potential requirements/impacts
Initial Resolution plan	<ul style="list-style-type: none"> ■ Formal Programme governance: <ul style="list-style-type: none"> - Steering Board for programme development monitoring and Design Authority for critical approach decisions - PMO and project tools - Internal mobilisation plan ■ Sustainable reporting infrastructure for on-going regulatory reporting and suitability to support resolution execution ■ Enhancement of MIS to provide a legal entity level in addition to divisional view
Structuring implications	<ul style="list-style-type: none"> ■ Legal entity structure – alignment to Critical Economic Functions and ring-fencing of NTNIA ■ Regulatory restrictions on intra-Group funding ■ Ring-fencing of shared services ■ Asset and liability matching for discrete pools of operational leverage and financial intermediation assets
Risk management	<ul style="list-style-type: none"> ■ Re-assessment of internal risk transfer arrangements ■ Measures to ensure continuation of Group wide risk management ■ Consideration of strategic, operational, legal and client related risk scenarios ■ Interaction of Resolution plan and SRMP with Business Continuity Management



Questions & Discussion

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