FINANCIAL STABILITY BOARD

10 November 2023

FSB Technical Workshop

Resolution planning for insurers: critical functions and digital innovation

Tuesday 20 June 2023, 13:00 – 14:30 CEST

Summary

On Tuesday 20 July 2023, the FSB's Cross-border Crisis Management Working Group for Insurers (iCBCM) held a virtual workshop on resolution planning for insurers. It focused on two topics within the scope of iCBCM's work: critical functions and digital innovation. In line with iCBCM's workplan for 2023, members had shared and discussed within iCBCM practices regarding the determination of **critical functions** of insurers. The workshop was an opportunity to share these practices also with industry participants and to hear views from industry experts on various elements regarding the identification of critical functions. **Digital innovation** is a technological trend that can be relevant for resolution from several points of view. The workshop was also an opportunity to share initial work on this matter with the industry and to discuss it from the perspective of the insurance industry.

1. Identification of Critical Functions

The Australian Prudential Regulation Authority (APRA) explained that the Prudential Standard CPS 900 Resolution Planning coming into effect from January 2024 requires Significant Financial Institutions (SFIs) and entities that provide critical functions to support APRA in the development and implementation of a resolution plan. APRA had already conducted an interim system-wide assessment considering the impact of the discontinuation of a critical function, its market share and substitutability. A function-specific analysis had assessed individual functions (i.e. business lines) in their own right while a concentration analysis had considered the provision of that function by a specific insurer. As a next step, a formal insurer specific critical functions assessments would be conducted as part of the resolution planning process, for which APRA would use the insurer's self-assessment as one of the inputs for its own assessment.

The Autorité de Contrôle Prudentiel et de Résolution (ACPR) presented an overview of the guidance developed in France. In a first step, ACPR has identified presumed critical functions for the market based on an analysis of the characteristics of the activities and of the impact of a discontinuation to the real economy or financial stability and on a general substitutability assessment. The assessment covered the impact on policyholders and beneficiaries resulting from a breach of protection, as well as impact resulting from the inability of the failing undertaking to honour its commitments, both including contagion effects on other counterparties. ACPR has identified savings, motor insurance, medical liability insurance, construction insurance, agriculture insurance and credit insurance as these functions which are critical by nature. In a second step, presumed critical functions for a given insurer are identified, based on analysis of the substitutability specific to a given group's portfolio and the market share of each group.

The People's Bank of China (PBC) and the China Banking and Insurance Regulatory Commission (CBIRC) provided an overview of the Chinese bottom-up approach to the identification of critical functions. Insurers conduct the assessment of their critical functions as part of resolution planning, having regard to their major financial products and services, which span insurance underwriting, claim settlement, insurance preservation, capital markets and investment activities, and other insurer-specific categories. Criteria used are market share, ranking of market share, number of customers, market impact, and substitutability. Given the big diversity of insurers in size, business structure and market specializing, the identified critical functions are diverse and include for example vehicle insurance, agriculture insurance, civil liability insurance, and banking functions within a conglomerate.

De Nederlandsche Bank (DNB) informed about the public interest assessment under the Dutch framework. This assessment is based on resolution objectives such as protecting policyholders, preventing significant negative impact on society, preventing significant impact on the financial system or the real economy, and preventing the use of public money. This analysis implied the identification of critical functions of an insurer by assessing the indicators which justify the public interest in resolution. Relevant indicators are the size of the insurer, type of insurance products, type of policyholders, expected shortfall at failure, interconnectedness with the financial system, impact on consumer confidence in the financial and insurance sector and substitutability in specific (niche) sectors. Provision of pension products, medical liability insurance and agricultural insurance have been identified as critical functions indicating a public interest in their continuity.

Industry participants commented that the criteria described by the presenters made sense as those assess (i) the materiality of the impact of a sudden discontinuation and (ii) the substitutability. They noted that these criteria ensure a focused approach and result in a limited set of functions, or better products, that could be critical. Participants noted it is also important to distinguish between the continuity of the protection by the insurance product and the continuity of underwriting new business for that product. More generally, it was pointed out that resolution planning is appropriate for big and complex groups but could be an excessive requirement for small insurers. Instead, a participant suggested that for these insurers, resolution planning could be designed as an early intervention measure which would be required if certain indicators were triggered.

Industry participants mentioned the impact on the economy and on policyholders, valuation in the market, and availability and ease of substitution as criteria used in their assessment of critical functions, distinguishing between ongoing and new business. Participants thought that starting with a self-assessment of the insurer was considered a good approach, while on the other hand they questioned certain thresholds applied to market shares in authorities' substitutability assessment. A participant viewed the impact of a discontinuation of an insurer as more relevant on the product side than on the side of investments in assets. It was also emphasised that insurers differ from banks not only with regard to their products, but also regarding the speed of a crisis.

2. Critical Functions and Digital Innovation in Resolution Planning

The FSB Secretariat presented work on resolution related aspects of digital innovation in the banking sector. Developments in digital innovation might be relevant for bank resolution under several aspects, for example with a view to the use of technologies by financial institutions and potential resolvability considerations, the use of new technologies by authorities for resolution preparedness ("ResTech"), the wind-down and resolution of FinTech firms that could be systemic in failure, and financial institutions' activities related to crypto-assets. The growing reliance of banks on third-party outsourcing for digital services could add complexity in ensuring continuity of critical services in resolution, and the increased use of social media, 24/7 payments and mobile banking could increase the speed of bank runs.

The FSB Secretariat informed about work on resolution related aspects of digital innovation in financial market infrastructures. Central counterparties (CCPs) for clearing and central securities depositories are venturing into using new technologies including distributed ledger technology (DLT). From a resolution perspective, direct and immediate access to information and record keeping of all entities in the platform in clearing or securities depositories could enable better-informed decisions in crisis. DLT may also facilitate all time collateral mobility and speedy collateral, which would change risk characteristics. Further issues to be investigated in relation to digital innovation in resolution planning include operational continuity and governance and finality.

Industry participants pointed out that the use of new technologies in the insurance sector was still developing and that digital innovation offered a lot of opportunities. Digital innovation could help to open new distribution channels, foster financial inclusion, reduce costs and risks, and prevent fraud. It could provide value for money for both retail and wholesale products, including by the development of parametric products. Generally, industry participants considered a crisis of an insurer to be more situation specific than driven by contagion. The impact of social media might be less severe than in the case of a bank failure, as policy surrenders could not be executed as fast as deposit withdrawals. However, reputational issues might persist.