FSB FINANCIAL STABILITY BOARD

FSB Technical Workshop

Resolution planning for insurers: internal interconnectedness and funding in resolution

Tuesday 12 July 2022, 13:00 – 15:00 CEST

Summary

On Tuesday 12 July 2022, the Cross-border Crisis Management Working Group for Insurers (iCBCM) held a virtual workshop on resolution planning for insurers. The workshop was chaired by Leonard Flink (De Nederlandsche bank (DNB)), who is the Chair of iCBCM. It focused on two topics on which the FSB had in early 2022 published two practices papers to facilitate effective resolution planning for insurers. The papers present practices on funding in resolution and on internal financial and operational interconnectedness. The FSB had invited feedback on these practices papers and had received several submissions which had been published on the FSB's website. The iCBCM Chair expressed his gratitude to the contributors who had shared their views. The workshop was an opportunity to hear views from industry experts on various elements in the practices papers.

1. Internal Operational Interconnectedness in Resolution Planning

Jeroen Brinkhoff (DNB) presented an overview of resolution authorities' practices in assessing internal operational interconnectedness.[1] He highlighted that the mapping of operational linkages provides important information on critical services delivered between entities of an insurance group. The assessment of those interlinkages informs resolution planning work in many ways, for example around resolution scenarios, operational continuity in resolution and resolution strategies. The practices paper presents several examples of mapping of intra-group interlinkages.

The industry participants welcomed the FSB's efforts to provide practical guidance on mapping and assessing interlinkages. There was general agreement on the need to better understand interconnections within an insurance group with a view to identifying and addressing potential impediments to resolvability. Insurers' contingency planning and risk management already include relevant mappings on which supervision and resolution planning can build. Some

[1] FSB (2022a), *Internal interconnectedness in resolution planning for insurers: Practices paper*, January.

participants suggested materiality thresholds should be much higher for insurance than for banking because the number of critical services within insurance groups that support critical functions is lower.

Regarding the identification of critical functions, industry participants were of the view that the relatively unconcentrated nature of insurance markets means that there is a lot of competition and products are highly substitutable. It was suggested that the criticality of functions should not be determined based on proxy factors such as market shares, but on potential effects on the real economy. Industry participants were of the view that, compared to the banking sector, insurers generally provide not as many critical functions and that, therefore, mapping requirements should be less stringent. Efforts and costs for extensive internal mapping may be justifiable where the mapped services support critical functions. However, they acknowledged that a large part of relevant mapping is already available within supervisory contexts.

Industry participants also commented on supervisory rules which have an impact on the interconnectedness within an insurance group or conglomerate. Examples mentioned were the rules and requirements on external and internal outsourcing activities, and supervisory reporting. Industry participants also mentioned capital requirements for large insurers at the group and individual entity level, also in a cross-border context. The allocation and availability of capital and collateral within large groups and across borders was identified as a challenging topic that requires a better understanding of the related interlinkages to identify and address impediments to resolvability and to ensure operational and financial continuity in resolution.

iCBCM members explained that data collected from insurers as part of the resolution planning process would inform the assessment of internal operational interlinkages and critical services, and the assessment of the impact of a failure of a group entity on the group.

2. Internal Financial Interconnectedness in Resolution Planning

Albane Miressou-Got (French Prudential Supervision and Resolution Authority (ACPR)), discussed internal financial interconnectedness drawing on the FSB's practices paper.[2] She highlighted that the mapping of financial interlinkages provided important information for the assessment of contagion effects within a group and the development of financial continuity strategies. Due to existing supervisory requirements, there was more relevant financial data available than data on operational interconnectedness. Resolution planning, however, requires more granular data for the assessment of financial interconnectedness than for the assessment of operational interconnectedness.

Industry participants emphasised that the transactions that created intra-group financial interconnectedness provided important functions within a group, such as intra-group reinsurance, statistical diversification, structuring of risk management, and enhancement of efficiency. These linkages could persist during all three lines of defence, group policy, recovery and resolution. The question was therefore not about eradicating them, but to understand their complexity. Mappings, for example via a network diagram, were considered useful but not without challenges. The determination of materiality of interlinkages or transactions was

[2] FSB (2022a), *Internal interconnectedness in resolution planning for insurers: Practices paper*, January.

considered difficult because the nature of the transaction could change over time along the runway of events, for example in relation to contingent guarantees. Contagion risks and propagation of risks should therefore not be considered a static concept. Therefore, authorities should look at intra-group financial interconnectedness sensitivity in a resolution context, rather than focusing too much on a perfect mapping of complex group structures. Due to the complexity of building quantitative models to complement qualitative assessments it was suggested to focus on ad hoc exercises for the time being and to develop a more detailed understanding step by step. Workshop authorities explained the use of quantitative data for the assessment of the impact of a failure of a group entity on the group.

Industry participants generally cautioned against over-engineering reporting requirements. It was suggested to focus reporting on a limited set of insurers with particularly complex structures or critical functions, in line with the principle of proportionality. Another suggestion was to focus the mapping on the point of entry rather than on the entire group so that impediments could be resolved in a focused way. It was noted that all relevant supervisory and resolution authorities of an international conglomerate need to be involved in the discussions during resolution planning and in the run-up to a crisis and resolution. The regulatory status of counterparties was mentioned as one important data point to be captured in this context. Participants questioned whether, with a view to resolvability, it was necessary to give the same weight to the mapping and documentation of internal financial interlinkages as to the identification and assessment of external financial interlinkages. For example, where internal arrangements are designed back-to-back with external transactions, sophisticated mapping could be very burdensome.

3. Funding in resolution

Clive Tan (Monetary Authority of Singapore (MAS)) presented an overview of the FSB's practices paper on resolution funding for insurers.[3] The paper covers internal and external sources of funding in resolution, discusses insurers' capabilities to ensure the accurate determination of internal funding sources and considers potential impediments to their utilisation or movement of funding sources. External sources of funding could be policy-holder protection schemes (PPSs) as well as standalone resolution funds. Some PPSs or standalone resolution funds are ex-ante funded while others are ex-post funded. The paper also covers temporary funding schemes that are relevant for ex-post funded PPSs or standalone resolution funds, as well as mechanisms for the recovery of funds used in resolution.

Industry participants stressed the differences between the banking and insurance sectors as regards funding needs and cash flows when it comes to a crisis. A liquidity crisis at a bank can trigger a bank run with a very fast dynamic which requires quick action to restore confidence. In the insurance sector, such runs are less likely to happen. Structurally insurers therefore are more likely to be faced with a solvency crisis than with a liquidity crisis. Recognising these differences would determine the view on resolution funding. Liquidity stress could cause the threat of an interruption of payments on claims of annuities or other contracts. Solvency stress could challenge insurers' ability to satisfy obligations stretching out over months or many years. PPSs could provide adequate funding sources for both types of stress. With a view to long-term claims such as annuity claims to life insurer, they could support responses to the failure of an insurer by covering the shortfall between the remaining assets and liabilities. Such support would be

[3] FSB (2022b), *Resolution funding for insurers: Practices paper*, January.

provided in the context of the application of resolution tools such as stepping into the shoes of the failed insurer to pay the claims as they arise over time or transferring the long-term claims together with the remaining assets to a solvent insurer or a bridge entity.

Industry participants mentioned an example where policyholders' claims were reduced by a small portion to support the funding of the failure. This participation would direct policyholders to avoid choosing products based only on price and therefore maintain insurers' incentives for good corporate governance. Other industry participants, however, stressed that assessing the health of an insurer was difficult even for sophisticated investors. Some participants highlighted that imposing haircuts on policyholders should only be used as a last resort, if at all, and only in relation to property/casualty claims suggesting that for life insurers instead, continuation of payments using bridge entities, buyers or run-off was important.

Industry participants emphasised the importance of early communication and coordination between PPSs and authorities in the run-up to a crisis and resolution, within or outside of crisis management groups (CMGs). They also agreed that policyholders would be better protected with PPSs or insurance guarantee schemes than without them. The approaches to the set-up of the PPSs taken in different jurisdictions were very diverse and in many jurisdictions PPSs have more functions than the compensation of policyholders. Industry participants cautioned against obliging the members of industry funded PPSs to fund the recovery, as this could result in insurers de facto funding their competitors.

Leonard Flink (DNB, iCBCM Chair) closed the meeting by thanking the presenters and the lead speakers as well as all attendees for their contributions.