



Central Bank Publishes Consultation Paper on Pre-emptive Recovery Planning for (Re)insurers

July 2020

On 25 June 2020, the CBI published a consultation paper (CP131) on “Regulations for pre-emptive recovery planning for (re)insurers”. The document proposes the introduction of formal obligations on (re)insurers to put in place pre-emptive recovery plans, on the basis that “... *adequate preparation and planning in the form of pre-emptive recovery planning should reduce both the probability of insurers failing and the impact of such failures.*”

WHAT IS CP131?

CP131 consists of 3 sections:

- 1) An introduction and background section;
- 2) Proposed regulations in the form of a draft statutory instrument; and
- 3) Draft guidelines that would be issued by the CBI to support the proposed regulations.

In the first section, the CBI sets out its objectives in putting forward the proposed regulations:

- a) Promote awareness and allow firms to prepare for a range of possible adverse situations;
- b) Enable firms to consider and evaluate the most appropriate and effective mitigation without the resulting pressures of actual severe stress; and
- c) Enable firms to make more effective, comprehensive and thoughtful measures to ensure their timely implementation if required.

The proposed guidelines are then designed to assist firms (i.e. insurance undertakings, reinsurance undertakings and third country branches of insurance undertakings) in understanding their obligations under the regulations.

The Draft Regulations – Requirements for Recovery Plans

The draft regulations are both extensive and highly prescriptive. The main elements of the recovery plan are set out under the following headings:

SUMMARY

Each of the aspects of the recovery plan set out below must be summarised, while the summary must also address the overall recovery capacity of the (re)insurer, the point at which closure to new business would take place, and how this situation would be managed by the (re)insurer.

GOVERNANCE

The Regulations require the recovery plan to be board-approved.

It must be reviewed and updated at least annually, or after any material change in the firm's structure, business or financial position.

The recovery plan shall provide for the following:

- internal reporting system must facilitate frequent monitoring of the recovery plan and ensure that the information required to make decisions in line with the plan is available in a timely way
- roles and responsibilities (including those of the board) in relation to preparing, implementing and approving the recovery plan must be documented
- integration of the recovery plan into the system of governance and risk management framework must be documented
- policies and procedures for timely implementation of recovery options, including escalation, decision-making and CBI notification procedures, must be documented.

STRATEGIC ANALYSIS

The recovery plan must provide information about the (re)insurer that is relevant to and important in understanding the recovery plan.

- this must address (each of these terms being further described in the document) “core business lines”, “key services”, and “critical functions”
- global business and risk strategy must be described, including the list of jurisdictions serviced by the (re)insurer
- key intra-group connections of the (re)insurer must be documented, including material financial exposures, risk transfer arrangements, guarantees and other support arrangements, operational and service arrangements including use of centralised functions
- information must be provided on material financial exposures and liabilities outside the group, and critical services outsourced to third parties.

RECOVERY INDICATORS

The recovery plan must include a framework of indicators that allow timely identification of the progression of risks that have potential to threaten the (re)insurer’s viability.

These indicators must include thresholds that trigger at different levels:

- increased monitoring of the risks;
- implementation of one or more recovery options; and
- escalation of an issue in line with governance requirements.

The calibration of those thresholds must be explained by the (re)insurer. Recovery indicators must:

- at least have reference to the solvency and liquidity of the (re)insurer;
- be relevant to the business model and strategy;
- reflect the vulnerabilities most likely to impact on the financial position;
- be sufficient in number in each of a variety of areas of the business;
- clarify the point at which the insurer would close to new business;
- be integrated into the governance framework and day-to-day decision-making; and
- be forward-looking.

RECOVERY OPTIONS

The recovery plan must set out a range of actions which could contribute to the restoration of the financial position / maintain viability. The actions must include the following:

- capital & liquidity actions with a primary aim to ensure viability of core business lines, key services and critical functions
- actions with a primary aim of conserving or restoring own funds through recapitalisation
- actions to ensure access to liquidity sufficient to maintain operations and meet obligations as they fall due
- actions to reduce risk profile and accordingly capital requirements, or to restructure business lines (including possible divestment of assets, insurance portfolios or business lines)

Each such action must then address:

- a sufficiently-detailed description to enable assessment (including by the CBI) of its expected impact and feasibility
- an impact assessment, covering:
 - solvency, liquidity, risk profile, profitability and operations (taking account, where relevant, of the (re)insurers branches and subsidiaries
 - external and systemic consequences, considering key services, shareholders, policyholders, counterparties and the (re)insurer's group, where applicable
- the process for determining marketability and valuing any proposed divestments
- all material assumptions made in addressing each of the above points
- a feasibility assessment, covering:
 - the risk associated with each action
 - a description and analysis of any potential impediment to timely implementation of each action (including impediments arising from group structures, where applicable)
 - an analysis of whether and how the above impediments could be overcome
 - an assessment of how operational continuity would be ensured
 - an assessment of the timeframe for implementation, and the effectiveness of the action in restoring the (re)insurer's financial position

If one of the recovery options involves financial support from a parent / group, written confirmation of the willingness to provide that support must be in place; a contingency plan in the event of that support not materialising must also be addressed.

SCENARIO ANALYSIS

The recovery plan must include a range of scenarios, including at least one scenario reflecting each of the following headings:

- a 'system-wide scenario' – an event with serious negative consequences for the whole financial system or the real economy;
- an 'insurer-specific scenario' – i.e. with serious negative consequences specific to the insurer;
- a scenario combining both of the above; and
- a scenario involving closure to new business but honouring agreements made prior to the date of closure.

If the (re)insurer's recovery options include provision of capital or liquidity from within its group, the recovery plan must include a scenario where that provision is limited. Each scenario in the recovery plan must be relevant, having regard to:

- the (re)insurer's business, investment strategy and reinsurance strategy;
- the (re)insurer's operating model;
- the (re)insurer's asset size;
- the (re)insurer's group structure and intra-group arrangements, exposures to counterparties and third-party outsourcing arrangements; and
- any identified vulnerabilities of the (re) insurer.

Each scenario must:

- reflect an event that would threaten the solvency of the (re)insurer, without timely implementation of a recovery option;
- include an assessment of the impact on own funds, liquidity, risk profile, solvency capital requirement and operations (including continuity of key services and critical functions);
- include an assessment of the effectiveness of each recovery option, in that scenario, in restoring the financial position / maintaining viability; and
- include an assessment of the adequacy of the framework of recovery indicators.

The recovery action appropriate to that scenario should be identified for each scenario.

In respect of the closure to new business scenario, an analysis must be completed of the actions needed to fulfil obligations to policyholders, including:

- Governance and oversight;
- Capital and liquidity requirements;
- How key services and critical functions would be maintained;
- Future expense assumptions and expected cost savings;
- Assumptions in respect of parts of the business that may be sold; and
- The timescale for completion of the actions involved (or for the relevant business to be transferred out, including costs associated with such a transfer).

Finally, the recovery plan must include a description of the overall recovery capacity of the (re)insurer across the full range of scenarios.

COMMUNICATION PLAN

The recovery plan must include an internal communication plan to staff and trade unions/other representatives for the implementation of recovery options. The recovery plan must include an external communication plan to shareholders/investors, the CBI, counterparties, financial markets, reinsurers, policyholders and the public for the implementation of recovery options.

INFORMATION ON PREPARATORY MEASURES

The recovery plan must include an analysis of any preparatory measures required to facilitate the implementation, or improve the effectiveness, of the recovery plan, including any preparations necessary to address any impediments to the recovery plan. A timeline for the preparatory measures' completion is also required.

Consultation responses are to be submitted by the deadline of **30 October 2020**.

CONTACT US

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