

January 7, 2019



Mr. Jonathan Dixon  
Secretary General  
Dr. Victoria Saporta  
Chairperson  
International Association of Insurance Supervisors  
Centralbahnplatz 2  
CH-4051 Basel  
Switzerland

Re: IAIS Draft Application Paper on Recovery Planning

Dear Mr. Dixon and Dr. Saporta:

The Institute of International Finance (IIF) and its insurance members appreciate the opportunity to comment on the International Association of Insurance Supervisors's (IAIS) Draft Application Paper on Recovery Planning (the Recovery Planning Application Paper) issued on November 12, 2018. The IIF and its members have commented on related materials, including our June 1, 2017 letter, which included specific comments on ICPs 10 and 12 and related ComFrame materials. We appreciate the revisions to and improved alignment of the ICPs and ComFrame related to recovery planning that followed the prior consultation and we welcome the additional opportunity to address issues related to recovery planning.

Our response addresses the following key themes:

- While we value the purpose behind recovery planning, in keeping with the important overarching principle of proportionality, supervisors<sup>1</sup> should have flexibility in deciding whether to impose a requirement for a recovery plan and in establishing guidelines for the scope and content of recovery plans.
- When an insurer elects to develop a recovery plan or in the event that a supervisor considers that such a plan is necessary for the insurer, the firm should have broad discretion to craft a plan that best reflects the nature, scale and complexity of the risks of the company and management's view of the measures that could be taken in the event that a severe stress materializes.
- Consideration of operational aspects of an insurer's business are relevant to recovery planning to the extent that they contribute to efforts to bolster capital and liquidity. Outside of this, operational aspects may be better addressed through the ORSA, ERM policies and processes or business continuity plans.

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<sup>1</sup> Unless otherwise specified, references to supervisors include both jurisdictional and group-wide supervisors.

- Paragraph 29 of the Recovery Planning Application Paper should be revised to state that host supervisors are not expected to require separate recovery plans. A separate requirement to develop a recovery plan at the local level is duplicative and inconsistent with the centralized capital pooling and risk management practices of many insurance groups.
- When an insurance group elects to or is required to develop a recovery plan, the legal entities that comprise the group should not be required to develop entity-level recovery plans.
- Supervisors' need for flexibility in imposing a recovery plan requirement and insurers' need for flexibility in designing and implementing a recovery plan should be reflected in less prescriptive language in the Recovery Planning Application Paper.

### **Overarching Comments on Application Papers in General**

In line with previous IIF comments, we have an overarching comment regarding the objectives of an IAIS Application Paper. According to the IAIS:

*“Application Papers provide additional material related to one or more ICPs, ComFrame or G-SII policy measures, including actual examples or case studies that help practical application of supervisory material.”<sup>2</sup>*

We agree with the stated objectives of an IAIS Application Paper and the emphasis on the ICPs and ComFrame as the foundational elements of the IAIS's supervisory materials. We would suggest that some of the content of recent Application Papers, including the Recovery Planning Application Paper, properly belong in the ICPs and ComFrame. Including additional content in the ICPs and ComFrame would allow stakeholders to comment on material aspects of the IAIS's approach to supervision at an earlier stage and in greater detail. The related Application Paper could then be focused on the stated objective of providing additional material related to the practical application of the ICPs or ComFrame, including examples or case studies. In the case of the Recovery Planning Application Paper, the current organization of the material among the ICPs, ComFrame and the Application Paper has made it difficult to comment meaningfully on the ICPs and ComFrame until the issuance of the Application Paper.

Moreover, the Recovery Planning Application Paper sets new supervisory expectations, which is not the objective of an Application Paper. The Recovery Planning Application Paper raises supervisory expectations through the use of the word “should,” which implies a limited scope of acceptable supervisory practices and exceeds the stated objective of providing “actual examples or case studies that help practical application.” Application Papers would better serve the stated purpose of providing examples or case studies to help the practical application of the supervisory material if the word “should” was replaced with “could” or “may.”

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<sup>2</sup> Draft Application Paper on Proactive Supervision of Corporate Governance, IAIS, 8 November 2018.

## **Supervisors Should Have Flexibility in Recovery Planning Requirements**

We value the purpose behind recovery planning in focusing management attention and discussions on the strategies and tools that would be available and most appropriate to respond to a range of scenarios that could lead to severe financial stress and pressure on an insurer's capital and liquidity levels. The development of a recovery plan can direct management attention to considering potential triggers that could indicate the onset of severe stress and to the range of plausible options that may be available to mitigate a severe stress. However, supervisors should have the ability to consider the extent to which the purposes of a recovery plan are satisfied by other regulatory requirements and management tools. Providing jurisdictional flexibility is in keeping with the important overarching principle of proportionality and focuses correctly on the desired outcome of recovery planning: to respond to possible severe stress events, while allowing for potentially different paths to achieving that outcome.

We note a range of jurisdictional and company practices with respect to the requirements for the development of recovery plans and ORSAs. In some jurisdictions, the ORSA serves as a stress test of the insurer's business plan and helps determine whether the company has the financial resources to implement its business plan. The recovery plan, in contrast, addresses how the company could respond to severe stress events. In other jurisdictions, the ORSA addresses the response to severe but plausible stress scenarios and, thus, can meet the objectives of a recovery plan. In the latter jurisdictions, the development of a separate recovery plan may be duplicative of the ORSA. In addition, some companies elect to extend the ORSA to encompass severe stress events in order to aid management awareness and planning, even if the ORSA requirements do not mandate the consideration of severe stress events. Supervisors should have the flexibility to permit companies to develop alternatives to recovery plans or to impose modified recovery plan requirements where appropriate. Duplicative recovery plan requirements burden both insurers and their supervisors.

Supervisors should have the flexibility to craft an approach that best reflects the legislative and regulatory frameworks of their jurisdictions, as well as their local markets. In some jurisdictions, a recovery plan requirement may not be the optimal approach to achieving supervisory goals and objectives. Likewise, a supervisory college may conclude that an alternative to a recovery plan would better address an insurance group's particular risks and potential stress scenarios.

Any supervisory decision to impose a requirement for a recovery plan should be preceded by a cost/benefit analysis and a clear articulation of the supervisory expectations for a recovery plan. Developing a recovery plan requires a considerable commitment of management time and resources, which may be better devoted to improving ERM or the ORSA process instead of developing a plan that may never be triggered and may become obsolete in a relatively short period of time. Absent a clear articulation of supervisory expectations, the process of developing a recovery plan may be a mis-direction of management resources.

The IAIS should acknowledge that the need for insurers to develop recovery plans is not analogous to the need for banking organizations to develop recovery plans. Insurers have more options under stress to restore regulatory capital levels and a longer runway in which to deploy those options, when compared

to banks. Moreover, insurers do not perform the same critical functions as banks. These differences support a proportional and flexible approach to insurance recovery planning.

### **A Recovery Plan Should Provide a High-Level Outline of Management Options and Preserve Discretion**

When an insurer elects to develop a recovery plan or in the event that a supervisor considers that such a plan is necessary for the insurer, the firm should have broad discretion to craft a plan that best reflects the nature, scale and complexity of the risks of the company and management's view of the measures that could be taken in the event that a severe stress materializes. We appreciate the language of Paragraph 41 of the Recovery Planning Application Paper that "...recovery plans should not commit an insurer to take any action without the Senior Management or Board first evaluating relevant information and deliberating on the best course of action." However, the Recovery Planning Application Paper also refers to the "activation" of recovery actions in a manner that could imply the use of pre-defined, specific triggers or criteria for such activation. We urge the IAIS not to adopt any language that would give rise to an expectation that an insurer would need to define in advance specific triggers or criteria for the activation of a recovery plan. A rigid approach that activates a recovery plan automatically based on pre-defined criteria or triggers would not provide management with the flexibility to respond proportionally to a range of potential severe stress scenarios.

The recovery plan should provide a high-level outline of plausible actions that the insurer could take in a severe stress situation; the insurer should retain wide discretion to implement the measures it deems most appropriate in light of the source of and circumstances surrounding the particular stress situation, including options not contained in the recovery plan. The recovery planning requirements should be aligned with, and not duplicate, the company's ORSA and ERM framework, as well as any other risk management tools employed by the insurer.

A properly designed trigger framework should include criteria that are indicative of severe stress. Paragraph 56 of the Recovery Planning Application Paper includes criteria that could be indicative of a level of stress far below the level expected to trigger a recovery plan. While we appreciate the need to monitor metrics related to capital, liquidity, asset quality, profitability, market conditions and operational conditions in a business-as-usual scenario, the Recovery Planning Application Paper should make it clear that a recovery plan is designed only to address the need to raise levels of regulatory capital and liquidity when the insurer is under severe stress. Paragraph 52 should be amended to clarify that a trigger framework does not identify risks or vulnerabilities; rather, a risk assessment underlies the development of any trigger framework that may be used in a recovery plan.

The outline of plausible actions to be taken under stress should be high level, as the precise implementation of a particular action will depend on the stress situation presented. When a severe stress materializes, it is essential for management and the board to be able to react expeditiously and flexibly and consider both options contained in the recovery plan as well as other options. Stress events often do not follow a predictable or linear path. Moreover, excessive prescription regarding the actions to be taken under stress can give management and the board a false sense of comfort regarding its resilience under stress. To the extent a recovery plan is expected to dictate a particular response or series of actions, it could be detrimental to the ability of the firm to recover from a severe stress.

Section 5.7, and Paragraphs 80 and 83 in particular, call for the development of stress scenarios and the mapping of recovery actions to stress scenarios. We agree that recovery plans should contemplate both idiosyncratic and market-wide stresses, as well as a combination of the two. However, attempting to define *a priori* the severe stress events that would be most relevant to the insurer may focus management attention on particular stress events to the exclusion of others. Similarly, mapping specific recovery actions to stresses may discourage management from thinking broadly about recovery options when a severe stress materializes and may incent reliance on a “playbook” for recovery planning.

### **The Focus of a Recovery Plan Should be the Restoration of Regulatory Capital and Liquidity**

We endorse Paragraph 56 of the Recovery Planning Application Paper, which states that the trigger framework should include quantitative and qualitative criteria and a forward-looking element, where possible. Box 1 sets forth a number of quantitative and qualitative criteria that an insurer could incorporate in its trigger framework, including both financial and operational criteria. Similarly, both financial and operational responses are included in the menu of recovery options outlined in Box 2 following Paragraph 64.

We would encourage the IAIS to focus on quantitative and qualitative financial criteria that are designed to highlight regulatory capital and liquidity deficiencies and on responses to a severe stress that are designed to restore the insurer’s financial health through the rebuilding of regulatory capital and adequate levels of liquidity resources. To the extent that operational triggers or recovery options are included in a recovery plan, they should have a nexus to the financial criteria and to the restoration of regulatory capital and liquidity that is needed to address a severe stress scenario. Otherwise, operational aspects may be better addressed through the ORSA, ERM policies and processes, or business continuity plans.

### **Host Supervisors Should Not Require Separate Recovery Plans**

Paragraph 29 of the Recovery Planning Application Paper should be revised to state that host supervisors are not expected to require separate recovery plans. A separate requirement to develop a recovery plan at the local level is duplicative and inconsistent with the centralized capital pooling and risk management practices of many insurance groups.

The supervisory college mechanism should be used to address the rare case where the group-wide supervisor fails to address adequately the need for recovery planning or the need for improvements in an insurer’s ORSA, ERM policies and processes or recovery plan.

### **For Insurance Groups, Legal Entity Plans Should Not Be Required**

When an insurance group elects or is required to develop a recovery plan, the legal entities that comprise the group should not be required to develop entity-level recovery plans. Requiring entity-level recovery plans from an insurance group would be a duplicative exercise that would not add value. Moreover, it is the proper role of the head of the group to develop a recovery plan and oversee any deployment of the plan.

## The Language of the Application Paper Should Retain a Less Prescriptive Approach

Supervisors' need for flexibility in imposing a recovery plan requirement and insurers' need for flexibility in designing and implementing a recovery plan should be reflected in less prescriptive language in the Recovery Planning Application Paper. We appreciate that, in many instances, the language of the Recovery Planning Application Paper utilizes the less prescriptive language, such as "may" or "could," that the IIF has been advocating in general for Application Papers. This less prescriptive language reflects the purpose of an Application Paper (i.e. to discuss a range of sound practices, rather than to set forth a supervisory expectation or standard) and advances the desired flexibility of any guidance regarding recovery planning. However, a less prescriptive approach is still needed in Section 5, Elements of a Recovery Plan, particularly in Subsection 5.3, Trigger framework, and in Subsection 5.7, Stress scenarios. Moreover, the language of Paragraph 49 appears to address requirements for both recovery planning by insurers and resolution planning by supervisors and we recommend that the IAIS make a clearer differentiation between the two.

We appreciate the IAIS's consideration of our comments and the dialogue between the IIF and the IAIS on these important topics. We stand ready to provide further input and engage in dialogue with IAIS members to advance policy initiatives related to recovery planning.

Should you wish to discuss this response, please contact Mary Frances Monroe ([mmonroe@iif.com](mailto:mmonroe@iif.com)) or Ningxin Su ([nsu@iif.com](mailto:nsu@iif.com)).

Yours sincerely,

A handwritten signature in black ink, appearing to read "Mary Frances Monroe". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Mary Frances Monroe  
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