Recovery and Resolution Plans in Banking and Insurance

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Disclaimer

The views expressed in this presentation are those of the presenter(s) and not necessarily of Milliman, Permanent tsb and PRMIA.

About the speaker

- **Bridget MacDonnell**
- Consulting Actuary
- Bridget is a risk consultant, working at Milliman. She recently co-authored a white paper entitled "Recovery and Resolution Plans: Dealing with Financial Distress" and was a member of the Actuarial Association of Europe (AAE) working group who prepared a draft response for the EIOPA discussion paper regarding a harmonised recovery and resolution regime.

- **Milliman**
- Milliman is among the world's largest providers of actuarial and related products and services. Milliman is an independent firm with offices in major cities around the globe.

About the speaker

- **Monika Smatralova**
- Head of Supervisory Review and Evaluation Process, Group Risk
- Monika is a senior risk practitioner. She has been working in risk functions of major high street and captive banks for the last 10 years. Monika is also actively involved in the senior leadership at PRMIA, successfully leading the Irish Chapter since 2013.

- **Permanent tsb**
- Permanent TSB is a full service retail and SME bank which serves personal and small and medium-sized enterprise customers in the Republic of Ireland via a multi-channel distribution network.

Financial Stability Board (FSB) Definitions

Recovery Plan:	"Identifies options to restore financial strength and viability when the firm comes under severe stress"

Resolution:	"When a firm is no longer viable or likely to be no longer viable, and has no reasonable prospect of becoming so"

- Regulators typically heavily involved
- Measures to write down obligations

Recovery and Resolution Developments

Ireland: No formal requirements. High on CBI agenda.

UK: Fundamental Rule 8 requirements – mainly only large companies engaged

France: National law in place – basis for increased RRP supervision for all insurers

Netherlands: New national law on the way – basis for RRP for all insurers

Romania: National law in place requiring RRP for all insurers

Globally: G-SIIs* required to carry out RRP, includes FSB guidance

*Global Systemically Important Insurers

EIOPA Opinion: **Recovery and Resolution regime for all (re)insurers**

IAIS: Insurance Core Principle (ICP) 10 & 12 adding weight

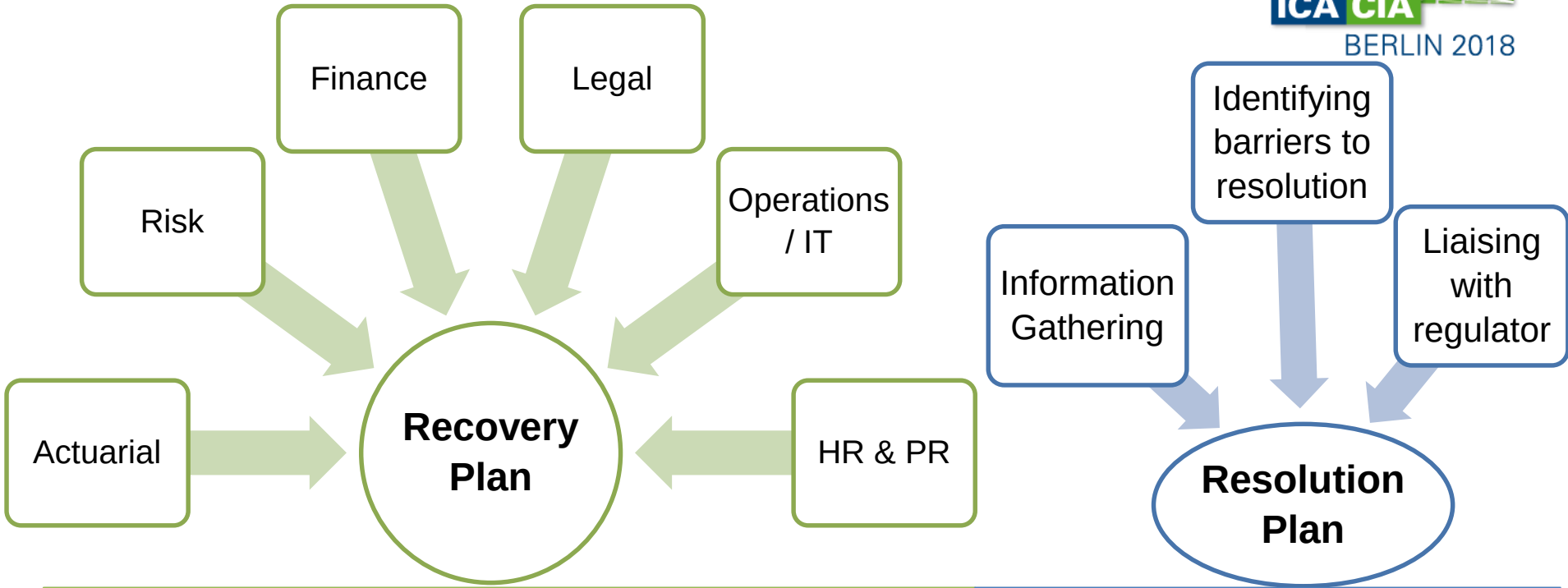
EIOPA Opinion – Recovery and Resolution Framework

EIOPA have called for a harmonised recovery and resolution framework for all (re)insurers in July 2017 following a qualitative assessment and consultation:

- Minimum harmonisation
- Recovery plans
- Early intervention powers not a new capital requirement
- Resolution powers – aim to preserve value
- *"...relevant in fragile market environments, like the current low interest rate environment"*

Building Blocks	
1. Preparation and planning	Pre-emptive recovery planning
	Pre-emptive resolution planning
	Resolvability assessment
2. Early intervention	Early intervention conditions
	Early intervention powers
Recovery	Solvency II ladder of intervention – out of scope Resolution
3. Resolution	Resolution authority
	Objectives, Conditions, Powers, Safeguards
4. Cooperation and coordination	Cross-border cooperation and coordination arrangements

Recovery and Resolution: What will it mean?



Recovery Options in Insurance

De-risking

- Longevity Transfer
  - *Case study: Aviva*
- Catastrophe Bonds & Swaps
  - *Case Study: Hannover Re*
- Reinsurance
- Investment related solutions
- Other capital management options

Restructuring

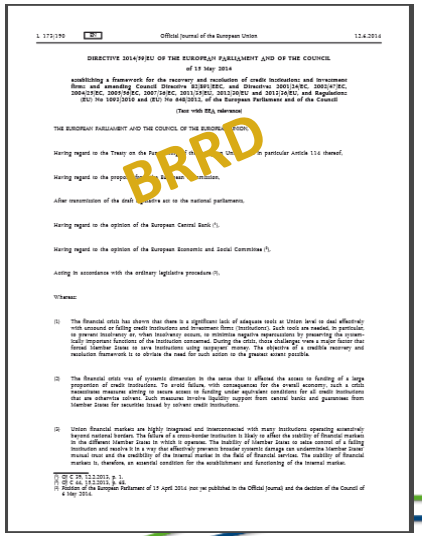
- M&A
  - *Case study: AIG*
- Branch Structure
  - *Case Study: MetLife & Zurich*
- New business options
- Existing business options
- Internal restructuring

Capital

- Subordinated Debt
  - *Case study: Great-West Lifeco*
  - *Case study: Norwegian insurer Gjensidige Forsikring*
- Hybrid Capital
  - *Case Study: FBD*
- Equity Capital
- Group Finance
- Off Balance Sheet Capital

Introduction to Recovery and Resolution in Banking

"We don't want banks to assume they can hold up their hands and get money whenever they are in crisis just because we are a cash rich country. Banks should assume no reliance on public funding going forward". Regulator



- Established by Regulation (EU) No 806/2014 on the Single Resolution Mechanism (SRM Regulation), the Single Resolution Board (SRB) has been operational as an independent European Union (EU) Agency since January 2015.
- 2017 is the fourth year of drafting recovery plans for banks.
- And it is **still evolving on both sides…**
- Resolutions Plans are drafted by the regulator and only partially shared with the banks.

So how it works practically….

BAU	Early Warning Stage	Recovery Stage	BAU
Isolated events constantly occur, they may reinforce each other and may become a threat. This creates potential scenarios with possible implications for a specific bank (or the whole system)…	…this should be captured with the Recovery Plan Indicators and Triggers…	…action is needed, recovery options are implemented by the bank…	…with the aim to achieve the running business within a specific period of time.

Scenarios		Indicators	Recovery Measures/Options	Indicators
Idio-syncratic (fast)	Impact		12 months	
Market-wide (fast)	Impact	➢ Capital Indicators ➢ Liquidity Indicators ➢ Profitability Indicators ➢ Asset Quality Indicators ➢ Market Indicators ➢ Macro Economic Indicators	➢ Capital Raising &/or Preservation ➢ Restructuring of Liabilities ➢ Cost Reduction ➢ Sale of Assets/Loan Portfolio ➢ Liquidity Improvement Recovery ➢ Reduction of RWA/Leverage ➢ Disposal Recovery Options ➢ Management Actions	**Back to 'Normality'**
Idio-syncratic (gradually, slow)	Impact			
Market-wide (gradually, slow)	Impact			
Combo – Idiosyncratic & market –wide (fast)	Impact			
Combo – Idiosyncratic & market – wide (gradually, slow)	Impact			

Example: Recovery Options in Banking

Awareness of the logistics of execution and its impediments is crucial.

Capital Raising	Capital preservation	Restructuring of liabilities	Sale of asset/loan portfolio	Liquidity Improvement	Reduction of RWA/leverage	Disposal Recovery Options	Management Actions/Cost Reductions
➢ Rights issue ➢ Ordinary capital increase ➢ Issue of mandatory convertible bond ➢ Issue of AT1 ➢ Issue of T2 ➢ Parent support ➢ Conversion of T2 capital into T1 capital ➢ Intra-group credit line	➢ No distribution of dividends to shareholders ➢ No payment of coupon on AT1/T2 issues ➢ Earnings retention	➢ Liability management transactions ➢ T2 instruments buyback ➢ Reduce the trading book ➢ Organic loan portfolio reduction	➢ Sales of leveraged loan portfolios ➢ Securitisation of portfolios ➢ Synthetic securitisation ➢ Asset sales – real estate	➢ Retained covered bonds ➢ Accessing central bank liquidity facilities with routine collateral ➢ Repo or pledge high-quality liquid assets ➢ Replace, sell, repo or swap non-high-quality liquid assets	➢ Unwind of portfolio management ➢ Unwind of fixed income financing ➢ Portfolio run-off ➢ Sale of strategic equity stakes ➢ Unwind of equity derivatives business	➢ Sale of business lines ➢ Sale of subsidiaries ➢ Sale of significant equity holdings	➢ Reduction in personnel ➢ Stop/delay IT investments ➢ Cancel bonus payment ➢ Reduction in working time ➢ Reduce lending ➢ Increase fee income

The selection of the appropriate option (s) depends on the severity and characteristics of the risk event, options may be combined in order to support the bank's return to the BAU status.

Case Study: recent cases

Banco Popular Español S.A. (7 June 2017, Spain)

- Driven by a significant deterioration of bank's liquidity situation (€2bn withdrawn a day)
- Collapse primarily attributed to 'toxic' real estate loans on its books and its failure to raise fresh capital
- SRB assessed that resolution of bank is in the public interest and adopted resolution scheme
- Shareholders and junior bondholders have been wiped out

Veneto Banca & Banca Popolare di Vicenza (25 June 2017, Italy)

- Driven by bad loans and dragged down by a mis-selling scandal
- Decision a result of lack of capital (failed attempts to raise fresh capital)
- SRB concluded that conditions for a resolution action were not fulfilled
- Banks to be wound up under Italian insolvency procedures (a total cost of up to €17bn)

Thank you very much for your attention!

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