Pre-emptive recovery planning: A first-timer's guide

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Currently expectations are that the new Insurance Recovery and Resolution Directive will be approved by the European Commission in the near future. One consequence is that most European insurers will soon need to have a pre-emptive recovery plan in place. This paper provides an overview of what insurers can expect when implementing such a plan for the first time along with lessons learned from jurisdictions where insurers already have pre-emptive recovery plans in place.

Introduction

BACKGROUND

The Insurance Recovery and Resolution Directive (IRRD) is a comprehensive framework for the insurance sector, covering elements such as recovery and resolution planning, resolution objectives and tools, and cooperation and coordination. One of its goals is the creation of harmonisation in recovery and resolution practices in the European Union (EU). Through these practices it aims to ensure that insurers and supervisory authorities are better prepared in cases of significant financial distress.

In November 2022, the European Insurance and Occupational Pensions Authority (EIOPA) organised a technical seminar[1] to further discuss the IRRD and its regulatory impact when approved. During this seminar, EIOPA indicated it expects the IRRD to be approved in the first half of 2023 but this might be delayed. Once approved, EIOPA has 18 months to set up guidelines, Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) to support the adoption of the framework. Following these timelines, it is likely that European insurance companies can expect the regulatory implications of the IRRD framework soon.

EIOPA is of the view that the harmonised recovery and resolution framework proposed by the IRRD should include a requirement for insurers to have both a pre-emptive recovery and a pre-emptive resolution plan in place.[2] Expectations are that having a pre-emptive recovery plan in place will be the responsibility of the insurer, whereas national supervisors—in the form of yet to be founded Resolution Authorities—are tasked with drafting the pre-emptive resolution plans. If the latter does indeed hold, EIOPA's requirement of having a pre-emptive recovery plan in place is going to be by far the most burdensome for insurance companies.

National supervisors will have to identify the insurers that are obliged to draw up these plans. Although the exact selection criteria are not yet known, it has been put forward that 80% of a Member State's market should be covered. This potentially includes mutuals and reinsurers as well.[3] More background on the IRRD and insolvency regulations for insurers in general, can be found in the IAA risk book.[4]

[1] EIOPA (18 November 2022). Technical Seminar on recovery and resolution in (re-)insurance. Retrieved 18 April 2023 from https://www.eiopa.europa.eu/media/events/technical-seminar-recovery-and-resolution-re-insurance-2022-11-18_en.

[2] EIOPA (11 February 2019). Institutions of the EU on the harmonisation of recovery and resolution frameworks for (re)insurers. Retrieved 18 April 2023 from https://www.eiopa.europa.eu/publications/institutions-eu-harmonisation-recovery-and-resolution-frameworks-reinsurers_en.

[3] EIOPA (10 November 2022). EIOPA staff paper on frequently asked questions about IRRD. Retrieved 18 April 2023 from https://www.eiopa.europa.eu/publications/eiopa-staff-paper-frequently-asked-questions-about-irrd_en.

[4] IAA (8 April 2016). Risk Book Chapter 11 – Resolution of Insolvencies. Retrieved 18 April 2023 from https://www.actuaries.org/iaa/IAA/Publications/iaa_riskbook/IAA/Publications/risk_book.aspx?hkey=1bb7bce0-2c43-41df-9956-98d68ca45ce46c_IAA_Risk_Book_Resolution_of_Insolvencies.DOCX

WHAT IS A PRE-EMPTIVE RECOVERY PLAN?

Solvency II already includes definitions of what constitutes a *recovery plan* versus a *resolution plan*:[5]

- A *recovery plan* articulates remedial actions to be taken where an insurer is in financial distress. The plan focuses on actions an insurer has available to enable it to continue to operate as a viable going concern. The plan will be developed, owned and approved by the insurer, and is subject to regulatory scrutiny.
- A *resolution plan*, on the other hand, will lay out the steps that will be followed when an insurer has run into such a state of financial distress that it can no longer operate as a going concern. Hence it will articulate the actions to be taken when a recovery plan has failed, detailing how policyholder obligations will be met in such a circumstance, e.g., transfer to another carrier. The resolution plan is drafted, owned, and approved by the regulator, with input provided by the insurer.

The recovery plans required by the IRRD differ slightly from these Solvency II definitions due to their pre-emptive nature. Where the recovery plan in Solvency II is only required to be drafted once an insurer finds itself in a situation of non-compliance with the Solvency Capital Requirement (SCR), the plan as prescribed by the IRRD is drafted in normal times of business and is intended to prepare the insurer for such an adverse event. In the remainder of this briefing note, we will refer to the pre-emptive recovery plan simply as *recovery plan* or *plan*.

GOAL OF THE BRIEFING NOTE

EIOPA needs to start drafting the exact requirements for the recovery plan once the IRRD is approved by the European Commission (EC). With consideration to recovery planning regulation already in place in some EU jurisdictions such as Ireland, France and the Netherlands, it follows that the spirit of what is in place is similar across all of these jurisdictions and is in line with what EIOPA proposes.

Comparing the plan requirements in detail across these countries, one could say that:

- Recovery plans in Ireland[6,7] are among of the most all-encompassing. Requirements outlined by the Central Bank of Ireland (CBI) are very clear and detailed in terms of the format of the recovery plan, and the resulting plans insurers already have in place look as though they will set the bar for supervisor requirements that may soon apply across the Solvency II jurisdiction.
- The CBI's requirements are in line with what is proposed by the IRRD and written by EIOPA in several related papers.

As such, we consider recovery plans in Ireland to be recovery planning best practice. We therefore use them in this briefing note as the basis of what insurers can expect when drafting a pre-emptive recovery plan for the first time.

Using our extensive experience with implementing recovery plans in the abovementioned jurisdictions, we also aim to provide further insight into how the plan can be implemented in such a way that it is not merely a compliance exercise, but also leads to new insights into the company's business and operations and improves its existing risk management framework and corresponding day-to-day operations.

Key takeaways

The key takeaways discussed throughout this briefing note are as follows:

1. In some EU countries insurers already have recovery plans in place. Out of them, we consider plans in Ireland best practice as they are very much in line with the IRRD and EIOPA proposals. Insurers that do not yet have a pre-emptive recovery plan in place can use local regulations on recovery plans from these countries as an example of what to expect in the near future.
2. Drafting a pre-emptive recovery plan requires considerable amounts of time and resources. Although the principle of proportionality does hold, realistically it can be applied to only a few specific areas of the plan. Careful planning and discussion as to whether the plan should be seen as a management tool, or merely as a compliance exercise, are therefore key before implementing the pre-emptive recovery plan for the first time.

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[5] Callaghan, C. & Dardis, T. (August 2022). It's not a recovery plan – it's a management action tool kit. Milliman White Paper. Retrieved 18 April 2023 from https://ie.milliman.com/en-GB/insight/its-not-a-recovery-plan-its-a-management-action-tool-kit.

[6] CBI (April 2021). Recovery Plan Guidelines for (Re)Insurers. Retrieved 18 April 2023 from https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/insurance-reinsurance/solvency-ii/requirements-and-guidance/recovery-plan-guidelines-for-(re)insurers.pdf.

[7] The formal text of the regulations is available at: https://www.irishstatutebook.ie/eli/2021/si/184/made/en/print

3. The plan ideally includes recovery indicators and options and scenarios covering solvency, liquidity and operational events. This does not only ensure that most of the key risks and vulnerabilities of the insurer are covered, but it also enables the plan to link in with areas of increasing regulatory focus, such as operational resilience, emerging risks, third-party outsourcing, and business continuity management.
4. Recovery indicators and options, and their surrounding governance and processes, require more attention than recovery scenarios. The main purpose of scenario analysis in recovery planning is to test the effectiveness of the recovery options, the adequacy of recovery indicators and triggers, and to identify any pre-emptive measure(s) to be taken to increase or ensure the effectiveness, feasibility and timelines of the options and triggers.
5. It is very likely that the scenario causing an actual recovery situation differs from the ones included in the recovery plan. Combined with the (very) extreme nature of these situations, we feel there is a limit as to how much effort should be put into quantifying the recovery scenario impacts. It is likely that a high-level impact assessment is still sufficient for recovery planning purposes.
6. The recovery plan is by no means an Own Risk and Solvency Assessment (ORSA). The ORSA tests the adequacy of a company’s current and prospective overall solvency needs and, by doing so, aims to *prevent* an insurer from breaching its Solvency Capital Requirement (SCR) and coming under severe stress. The pre-emptive recovery plan on the other hand, envisions the insurer as *confronted* with severe stress and contemplates the actions needed to mitigate that stress and restore financial strength and viability.
7. Recovery indicators should be such that they support the monitoring and progression of key risks so that if deployment of a recovery option is necessary it can be implemented in a sufficiently timely manner. For this to hold, indicators should be in place that are forward-looking in nature. In practice, the number of this type of indicators available is typically limited and meeting this requirement can therefore be challenging.
8. One of the uses of the plan is that senior management has an exhaustive and concise menu of options already at hand, on which they can base their decisions in times of distress. Using a structured approach for the assessment of each option supports this decision making as it ensures completeness, allows for better comparability between available options and enables senior management to have the appropriate bird’s-eye view.
9. For financial and liquidity scenarios, recovery options can be considered more as one-size-fits-all. For operational risk scenarios however, options are typically bespoke to the scenario they are applied to. Describing operational recovery options and scenarios in an exhaustive and at the same time concise manner, therefore, requires some initial thoughts on how to structure the recovery plan document that needs to be drafted.
10. Considering extreme scenarios where what at first appears to be a small risk or vulnerability leads to distress, when done correctly, can force insurers to evaluate their risk profiles in an in-depth manner that is different from most (if not all) existing risk management processes. Recovery planning can therefore yield some invaluable insights into the operations of the business as an ongoing viable concern. This of course, is the focus of executive senior management and the board of directors, and hence can potentially contribute to strategic management decisions.
11. Recovery planning can contribute to the further improvement of an insurer’s risk management framework. Risk monitoring and reporting is improved by adding recovery indicators and limits. Capital management plans are revisited and expanded, and the organisation is further future-proofed by resolving risks and impediments identified throughout the recovery planning cycle.

Objective, scope and timelines

MAIN OBJECTIVE OF THE RECOVERY PLAN

The main objective of the recovery plan is to ensure a thorough understanding and an increased awareness of the insurer's overall recovery capacity, in terms of both quantum and speed. This gives the insurer insight into the degree of (financial) deterioration it could absorb and still be able to restore its financial position and maintain its viability. To do this, the plan needs to provide detail on:

1. The extent to which an insurer is able to return to a going-concern position in different adverse scenarios, by using recovery options realistically available in these scenarios.
2. The time required for the various recovery options to have the expected impact.

Next to raising awareness on recovery limits, recovery planning enables insurers to consider and evaluate the most appropriate and effective mitigation in adverse situations without the resulting pressures of actual severe stress. It also enables firms to take more effective, comprehensive and thoughtful measures to ensure their timely implementation if required. Furthermore, it should increase the board's understanding of the business and its strategy and improve the management of the business accordingly.

The restoration of an insurer's financial position or viability does not necessarily imply returning exactly to its pre-stress position or business model. For most countries where insurers already have a recovery plan in place, viability also includes being able to enter an orderly solvent run-off where the insurer permanently closes to new business but continues to honour agreements made prior to that date. Recovery plans therefore also identify the point at which entering solvent run-off is the most appropriate option unless it would not be a reasonable recovery option under any circumstance.

SCOPE OF THE PLAN

Considering an insurer's risk profile and the full breadth of its related key risks and vulnerabilities, one could conclude that adverse scenarios leading to recovery do not always have to be (directly) related to an insurer's solvency position. Instead, liquidity and operational stresses can threaten an insurer just as well. Think for instance of a cyber-attack. Even with a solvency coverage ratio well above 100%, not being able to access critical systems for a longer period, can still cause failure of the insurance company.

There is currently no clear consensus on whether to include operational risk as a risk category in recovery plans. On one hand, both the CBI and the Prudential Regulation Authority (PRA) require plans to consider solvency, liquidity and operational events. Recovery plans in these jurisdictions typically include them as distinct risk categories, each with its own range of recovery triggers, options and scenarios. The Dutch supervisor (DNB), on the other hand, does not require the inclusion of operational risk as a separate category.

EIOPA's stance on this is not yet fully clear. We do consider including operational risk as a distinct risk category a best practice. Not only can an operational event on its own cause the failure of an insurer, it also has a clear interlinkage with liquidity and solvency risk. It is therefore reasonable to assume that a recovery plan is going to include operational risk and—related to this—operational resilience in one way or another.

TIMELINES

EIOPA indicates[8] that plans should be reviewed on a regular basis and updated if necessary, including to reflect any changes in the external environment, which may affect the ongoing feasibility of recovery options.

A review might also be necessary after a change in the legal or organisational structure of the insurer, its business or its risk profile, where such a change could have a material effect on the recovery capacity of the insurer, or necessitate a change to the plan. Such a review might be prompted by the deployment of a recovery option, which may limit its further use in the future. In that regard, timelines and triggers for updating the recovery plan are comparable to their ORSA counterparts.

[8] EIOPA (11 February 2019), Institutions of the EU, op cit.

In the Netherlands, recovery plans are currently updated once every three years. In Ireland this is done annually for higher-risk entities, and every two years for lower-risk entities, as per the CBI's risk-based framework. Although there is some divergence in terms of timelines across countries, we expect EIOPA to require an annual update as well.

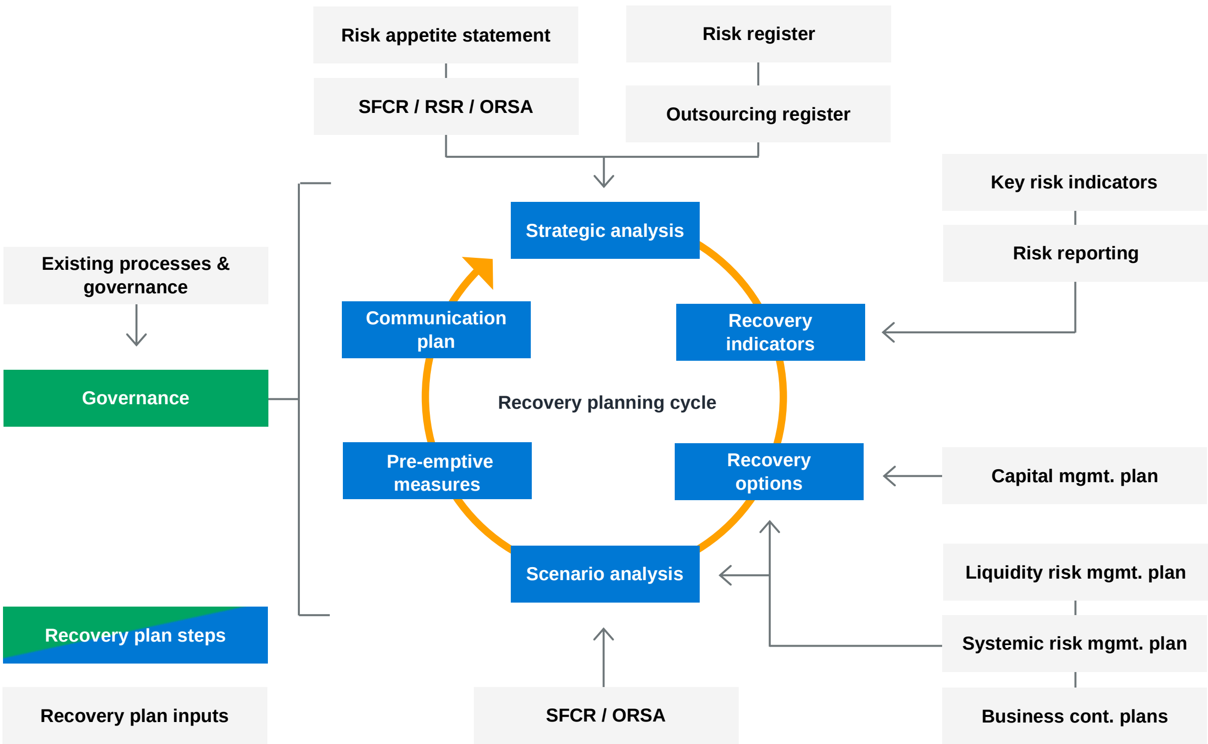
Nonetheless, appropriate timelines also depend on an insurer's view on the recovery plan. Is it merely a compliance exercise to be submitted to the regulator, or is it a risk management tool that forms an integral part of the normal day-to-day management and risk management framework of the company? We discuss this in more detail later in this briefing note.

General structure of the plan and potential requirements

INTEGRATION AND INTERLINKAGE WITH THE RISK MANAGEMENT FRAMEWORK

Determining the overall recovery capacity of an insurer is typically done through a thorough analysis of an insurer's risk profile and the risk monitoring and recovery options available to it. The CBI requires insurers to use a predefined document structure for this, with a fixed set of guidelines to comply with. The main elements of this structure are shown in Figure 1.

FIGURE 1: THE CBI RECOVERY PLANNING CYCLE AND ITS INTERLINKEAGE WITH OTHER PROCESSES IN THE RISK MANAGEMENT FRAMEWORK



Next to giving insight into an insurer's overall recovery capacity, regulators also see recovery planning more and more as a fundamental element of an insurer's risk management tool kit. The underlying idea is that crisis prevention is less expensive and more effective than crisis management. To achieve this, the recovery plan should be part of the insurer's overall risk management framework and day-to-day governance and processes, and insurers should make sure that:

- Appropriate policies and procedures are in place for the development and review of recovery plans on an ongoing basis
- The board shall formally assess and approve each version of the recovery plan
- The plan is ideally tested or independently reviewed to ensure it is realistic and operationally effective

To further ensure this, recovery plans should include details of the governance arrangements, policies and procedures to ensure the timely implementation of recovery options if required. These details would include identifying those responsible for monitoring early warning indicators, escalating potential issues, invoking the plan and managing the recovery process, as well as identifying the executive director with overall accountability.

In addition to having a recovery plan in place, an insurer needs to ensure that the plan is adequately supported by its management information system. This system will need to be capable of enabling timely and accurate reporting of relevant recovery indicators. In addition, insurers need to anticipate the potential information needs for evaluating and executing recovery options and to ensure that relevant and reliable information will be available in a timely manner even when under stress.

Incorporating the recovery plan in an insurer’s risk management processes means that there should be interlinkages between the recovery plan and other relevant processes such as the risk appetite statement (RAS), ORSA, contingency planning and other preventive or corrective measures that the insurer already has in place. Because the scope of the plan is relatively wide (e.g., solvency, liquidity and operational risk), there is quite a lot of overlap between the plan and other processes in the insurer’s system of governance and risk management framework. This also follows from Figure 1 above where we show some potential inputs feeding into the core steps of the CBI’s predefined recovery planning structure.

In the sections hereafter we use this CBI structure as a basis to provide more detail as to what EU insurers can expect from upcoming regulations and when implementing recovery planning for the first time. This includes examples and explanations for how each step in the recovery planning cycle relates to other processes in the insurer’s system of governance and risk management framework.

STRATEGIC ANALYSIS

This is the natural starting point of any recovery plan and is key to its credibility. Its objective is to provide a clear overview of the key facts about the insurer’s business strategy, operating model, risk profile and organisational structure that are relevant to recovery planning. This is with a view to identifying the insurer’s:

- Core business lines, key services and critical functions to be maintained during and following recovery from an adverse scenario
- Key risks and vulnerabilities that can lead to a recovery scenario

The analysis enables an insurer to make an informed assessment of the choice of recovery indicators, recovery options and scenarios used for testing the adequacy of the plan. As such, the strategic analysis serves as the basis for most (if not all) other steps in the recovery planning cycle and is key to the plan.

To achieve this, the analysis should cover the following areas:

- **Core business lines**: This includes matters such as the scale, profitability or capital requirements of various business lines and markets and their contributions to the future viability of the insurer. Typically, this information is already included in the Solvency and Financial Condition Report (SFCR) and Regular Supervisory Report (RSR).
- **Key services:** Looked at from the perspectives of both the current policyholders and claimants, and the wider economy.

- Key services for the wider economy are services the insurer provides as (one of) the only provider(s) in the market. If there are, for instance, only two insurers in the market writing pension business, then the failure of one of them would severely limit the options for policyholders wanting to take out pension products in that market. Offering pension products in this case is a key service to the wider market. Other examples are selling mortgages or providing asset management services.
- As key services typically concern the organisation as a whole, separate workshops and analyses are usually organised to identify all key services to be covered in the plan.
- **Critical functions:** Activities required to provide the insurer's key services. Consideration should be given to both direct activities such as policy servicing, claims payment or investment management, and to support activities such as IT services, human resources (HR) or payment and custody capabilities.
- **Business and risk strategy:** All key success drivers and potential risks inherent to these strategies are discussed.
- **Business and operating model:** This includes key financial and operational dependencies and the main jurisdictions in which they are active whether through a legal entity, a branch or on a freedom of services basis.
- **Internal interconnectedness:** Connectedness with the larger group of which the insurer is a member. This should include any details around intra-group arrangements in place, whether they are financial or operational.
- Examples of financial arrangements are arrangements around dividends, credit facilities, guarantees or reinsurance arrangements with the group. On the operational side, some key functions such as asset management or marketing may be centralised and outsourced to the group. Internal interconnectedness can also exist due to legal agreements such as distribution or cost-sharing agreements.
- **External interconnectedness:** Connectedness with external parties. Exposures to third parties that are significant for the insurer and can lead to recovery may include dependencies with distributors, shared services provided by reinsurers, outsourcing arrangements or guarantees provided by third parties.

For many insurance companies, a lot of the information that is relevant for this section—such as the insurer's business strategy, operating model, risk profile and organisational structure—is already included in existing documents such as the SFCR, RSR and ORSA.

When operational risk is also considered as a key area of the plan, detail on third-party-related risk relevant to the analysis can be available through for instance the outsourcing register. Given the recent increased focus on outsourcing risks by local regulators, however, it is likely that this area is also covered in detail in the SFCR and RSR.

More details on the key risks and vulnerabilities part of this section are likely to be also included in the insurer's RAS and risk register. The objective of the RAS is to set out the insurer's overall risk strategy and risk tolerances ("risk appetite"). What types of risk is the insurer willing to take and to what extent?

RECOVERY INDICATORS

The objective of this part is to set out how the insurer will monitor the development and progression of key risks so that, if deployment of a recovery option is necessary it can be implemented in a sufficiently timely manner. For each key risk and vulnerability identified in the strategic analysis, a range of recovery indicators and associated limits and thresholds (or "triggers") is defined. When breached, they will prompt the insurer to take specific actions, for example increase monitoring, escalate issues to an appropriate governance body or invoke the recovery plan and implement recovery options.

When integrated into the insurer's existing risk management framework and processes, the recovery indicator framework typically consists of several stages, each with its own governance and—potentially—management actions. Typically, the following limits are included in the insurer's indicator monitoring framework, once recovery and resolution planning are included as well:

- **Business as usual (BAU):** The insurer's current performance is in line with the insurer's risk appetite. There is no need for more frequent monitoring or implementing management actions that aren't already planned for.
- **Risk appetite breached:** One or more risks within the RAS are breached. The appropriate governance is followed, and management is informed accordingly. Relevant indicators are monitored more frequently, and the company can consider implementing management actions that are considered effective but with a minor impact on the current nature of the business.

- **Early warning indicator triggered:** Key limits in the insurer's RAS or similar are breached, indicating that immediate action needs to be taken to prevent the insurer from going into recovery. Senior management is informed appropriately and updated frequently, and management actions are implemented that typically have bigger impacts on both the financial and liquidity position of the company and, at the same time, the larger organisation and its operations.
- **Recovery indicator triggered:** Invoking the recovery plan and its corresponding crisis governance, processes, communication plan and actions. At this stage, management actions with a major impact on the organisation and nature of the business are in scope as well. Examples are to sell parts of the business or to stop writing new business.
- **Resolution:** In case indicators imply that recovery actions are not sufficient anymore for the insurer to return to a going concern status or to ensure a solvent run-off. At that point, the insurer enters resolution and the resolution authority of the local supervisor takes over control.

An illustrative example of how this could look in practice is shown in Figure 2. In this example the insurer uses several recovery indicators to monitor its risks and weaknesses. Financial stability is monitored using the solvency coverage ratio as an indicator. The liquidity position is monitored by the insurer's liquidity buffer and operational risk is monitored by reporting the number of IT incidents that come in every week. Please note that we included a resolution threshold here for completeness. Resolution is typically invoked by the local supervisor, not the insurer.

FIGURE 2: EXAMPLE OF RECOVERY INDICATORS, THRESHOLDS AND CORRESPONDING MANAGEMENT ACTIONS AND GOVERNANCE IMPLICATIONS

REPORTED RISK INDICATOR		RISK APPETITE	EARLY WARNING INDICATORS	RECOVERY PLAN INDICATOR	POINT OF NO VIABILITY
RECOVERY INDICATORS	**BAU**	**BELOW RISK APPETITE**	**INCREASED MONITORING**	**RECOVERY**	**RESOLUTION**
Solvency coverage ratio	>150%	[130% - 150%]	[100% - 130%)	[60%-100%)	<60% (MCR)
Liquidity buffer	>75 days	[25 days – 75 days]	[7 days – 25 days)	[3 days – 7 days)	<3 days
IT incidents	<5 per week	[5 – 10] per week	[11 – 15] per week	[16 – 30] per week	>30 per week
RECOVERY PLAN IMPLICATIONS					
Management actions	No actions required	Minor impact actions	Medium impact actions	Major impact actions	Resolution activities
Governance	BAU monitoring	Increase monitoring	Escalate issues	Invoke recovery	Invoke resolution

Relying only on key risk indicators (KRIs) and related risk reporting to support the insurer's risk appetite is generally not considered sufficient for the purposes of recovery planning. These measures are mainly intended to report the vulnerabilities inherent in the risk appetite to the board of directors of the insurer and to ensure that there is regular reporting on compliance with the risk appetite.

Instead, recovery indicators should support the identification of emerging stresses arising from the insurer's risk strategy and of the measures that could be taken to maintain or restore the financial position of the insurer in the event of a severe stress. Hence, KRIs and risk reporting can be used as a starting point for recovery triggers, but additional limits and thresholds need to be defined so that risk reporting is also fit for recovery purposes.

The CBI expects insurers to put in place recovery indicators based on an insurer's internal financial measures such as solvency, liquidity, profitability and reserving. It also expects them to look to external data such as market-based and macroeconomic indicators. There are several sources outlining examples of recovery indicators to consider. The European Banking Association (EBA), for instance, has published a minimum list of qualitative and quantitative recovery plan indicators.[9] The PRA expects firms to follow these guidelines alongside their own insurance-specific guidelines.

Ultimately, the aim of this part of recovery planning is to have a set of indicators in place that warn the insurer early enough to allow it to prevent or adequately prepare for potential (near-) future recovery situations. To ensure this, it should hold that the set of indicators defined and implemented are:

- **Relevant:** To the insurer's business model, strategy, risk profile and main vulnerabilities as identified in the strategic analysis.
- **Sufficient in number:** In each of a variety of areas of the insurer's business, to appropriately reflect the size and complexity of the insurer. The number of indicators should, however, still be manageable such that the recovery indicator framework is an effective risk management tool.
- **Include appropriate thresholds:** Indicating what type of actions to take in case each threshold is breached. Typically, a traffic-light approach is used where multiple thresholds are set for each indicator, with progressive corresponding management actions.
- For example, when considering the solvency coverage ratio as an indicator, breaching a threshold of 150% is reason for the insurer to evaluate its risk profile and its future own solvency adequacy, and to consider management actions with a relatively minor impact such as revisiting the strategic asset allocation. Breaching a 130% threshold, however, potentially requires more immediate and material actions such as capital injections from the larger group or reinsuring part of the book.
- **Frequently monitored:** To ensure that the insurer can appropriately respond to adverse situations. Also, when an insurer proposes a more frequent monitoring of indicators in case thresholds are breached, the recovery indicator framework should be such that it is capable of supporting it.
- **Integrated in governance:** The indicators and their monitoring, reporting, review and recalibration should be integrated into the insurer's governance framework, forming part of its decision-making procedures.
- **Forward-looking in nature:** To ensure sufficient early warning indicators, these indicators should be forward-looking. In practice, the number of this type of indicators available is typically limited and complying with this requirement can therefore be challenging. This especially holds for operational risk. Examples of forward-looking indicators insurers have in place include profitability, solvency scenario testing and the liquidity coverage ratio.

The CBI requires insurers to consider *closure to new business* as a separate recovery option. To ensure a solvent run-off, recovery indicators and thresholds should be in place supporting the decision when closure to new business is a viable recovery option. Because this recovery option has both solvency, liquidity and operational consequences, it is likely that multiple recovery indicators and thresholds should be in place, supporting this decision.

RECOVERY OPTIONS

This part of the recovery planning cycle details a range of actions the insurer may take to restore its financial position or maintain its ongoing viability in the event of a severe stress event. Along with having appropriate recovery indicators in place, identifying and assessing recovery options is one of the most important facets of recovery planning. It is key that insurers consider an exhaustive range of options, because not all options will be effective in all recovery scenarios. Getting a capital injection from the larger group, for instance, will not be very helpful when the recovery scenario is caused by a failure in IT systems.

[9] EBA (6 May 2015). Final Report: Guidelines on the Minimum List of Qualitative and Quantitative Recovery Plan Indicators. Retrieved 18 April 2023 from https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1064487/4bf18728-e836-408f-a583-b22ebaf59181/EBA-GL-2015-02%20GL%20on%20recovery%20plan%20indicators.pdf?retry=1.

To ensure a sufficient range, recovery options considered could be both extraordinary in nature as well as measures taken in the course of the normal business. Also, options should not be excluded for the sole reason that they would require changes to the current nature of the business of the insurer.

Senior management decides which of the identified options to use in a recovery scenario once the stress event unfolds or is about to. To facilitate their (future) decision making, the recovery plan should include an assessment of the likely impact, feasibility and timelines of each of the options.

The key outcome of this section of the plan is therefore that there is a clear and credible rationale for the insurer's view on the potential impact of the recovery action under various conditions and the feasibility of successfully executing the action within an appropriate timescale in different circumstances.

Some examples of recovery options an insurer could consider in its recovery plan are:

- **Solvency:** Delay dividend payments to the larger group or shareholders, reinsure (part of) the back-book, increase own funds by attracting a capital injection, contingent capital, sell liability portfolios, change the new business mix or de-risk the asset portfolio.
- **Liquidity:** Collateral management, defer claim outgoes, delay optional expenditures, securities lending, sell investments, lay off staff, utilise contingent liquidity facilities such as overdrafts, repo arrangements or other short-term lending facilities at the insurer's disposal. Other liquidity management actions can also be found in a separate Milliman white paper.[10]
- **Operational:** The use of back-up IT systems or office space. Replace current processes with temporary third-party sources.
- **Closure to new business:** Assessing when an insurer should stop writing new business is one of the key outcomes of the recovery plan. Insurers therefore usually include closure to new business as a separate recovery option in their plans.

It is likely that there are already several processes in place at the insurer that can be used to both identify and assess potential recovery options. To improve an insurer's solvency position in times of distress, capital management actions included in the business plan, ORSA or designated capital management plan can for instance be used. The Systemic Risk Management Plan (SRMP), as required by Solvency II for some insurers, might also contain useful inputs for potential recovery actions in case an insurer's solvency coverage ratio is below 100%.

For liquidity risk, the Liquidity Risk Management Plan (LRMP) can be used, which outlines the liquidity management policy, buffers, scenarios and corresponding management actions. For operational risk, business continuity plans can be used as input for recovery options.

Once all potential recovery options are identified, both their impact and their feasibility need to be assessed. The impact assessment covers the financial, operational, organisational and any external or systemic consequences of implementing the recovery option. It is important that assumptions in the impact assessment are set realistically, given that the option is exercised in adverse times. An overnight disposal of assets or a portfolio transfer, for instance, likely takes place against a discount. The same holds for a reinsurance arrangement. In adverse times it might be that demand for such arrangements is higher, increasing the reinsurance premium to be paid as well as the implementation times.

The feasibility assessment includes areas such as risks associated with implementing the recovery option, regulatory requirements that apply, expected timelines, operational impacts and material impediments to the effective and timely execution of the option. The assessment of operational impacts includes any arrangements and measures in place necessary to maintain continuous access to relevant market infrastructure and continuous functioning of critical functions and operational processes, both internally and outsourced ones.

[10] Booth, C., Fulcher, P., et al (June 2019). Liquidity risk management: An area of increased focus for insurers. Retrieved 18 April 2023 from https://assets.milliman.com/ektron/Liquidity_risk_management_An_area_of_increased_focus_for_insurers.pdf.

Where the insurer is part of a wider group, multiple recovery options may be dependent on support from the group. When assessing the feasibility of these options, an insurer should consider in which cases the group is able to provide this support and in which cases it is not. There should be explicit proof that group support is indeed available in times of stress.

To further support decision making, an insurer could choose to further categorise its recovery actions based on their impact on the organisation and the current nature of the business. Which options identified and assessed could also be taken in the course of normal business, and which options are considered a last resort?

In line with the illustrative example in the previous section and shown in Figure 2 above, categorising recovery options could for instance be done as follows:

1. **Minor recovery options:** Options that have a minor impact on the insurer's organisation and/or business plan. Typically, these options would be actions that are already part of the capital or liquidity management plan but are now being prioritised. Examples would be the hedging of equity exposures, delay optional expenditures or mitigating part of the longevity risk using excess-of-loss reinsurance or out-of-the-money longevity swaps.
2. **Medium recovery options:** Options with a more material impact, that are not already planned for and with a potentially bigger impact on the insurer's operations. Examples are the delaying of planned dividend payments to the larger group, selling assets, triggering contingent capital or de-risking the asset portfolio.
3. **Major recovery options:** Options that have a material impact on both the financial and current nature of the business. These options can be considered a last resort and are typically not considered if the insurer does not have to. Examples are portfolio transfers, reinsuring large parts of the back-book, delaying claim outgoes, making staff redundancies or a stop to writing new business.

In the event recovery limits or thresholds are breached, senior management would start considering minor recovery options. If these options are not sufficient to go back to a BAU situation, only then would the medium and major options enter into scope.

At the end of the day, the purpose of the recovery options section of the plan is to provide senior management with an exhaustive and concise menu of options they can base their decisions on in times of distress. We feel that using a structured approach for the assessment of each option supports this decision making as it ensures completeness, allows for better comparability between available options, and enables senior management to have the appropriate bird's-eye view. Defining a suitable and sufficient structure does requires some thought and can best be done prior to doing the assessments themselves.

SCENARIO ANALYSIS

The aim of this part of the recovery plan is to test the effectiveness and completeness of recovery indicators, options and surrounding processes and governance. In essence, testing the effectiveness of the plan can almost be considered as *dry running* the plan.

With respect to indicators, the analysis of each scenario should consider which recovery indicator would be triggered and when. The effectiveness of recovery options available is evaluated by assessing the impact of the scenarios on the insurer before and after implementing recovery options, with particular emphasis on capital, liquidity, risk profile, profitability, operational capacity, reputation and credit rating.

To be able to test recovery indicators and options appropriately, the scenarios should be such that—without recovery measures in place—it is likely that they would lead to failure of the company. In line with what EIOPA and other local regulators impose, the CBI requires that, at a minimum, the following scenarios are to be included in the recovery plan:

1. **System-wide scenario:** Event that risks having serious negative consequences for the financial system or the real economy.
2. **Insurer-specific scenario:** Event that risks having serious negative consequences specific to the insurer.
3. **Combined scenario:** A scenario that combines the simultaneous occurrence of both 1 and 2 above.

Furthermore, the CBI requires that insurers include the following type of scenarios in the analysis:

1. **Slow-moving:** Where the (financial) position of an insurer deteriorates over the course of a few years, gradually causing the insurer to be in a recovery situation.
2. **Fast-moving:** Where an adverse event takes place in a sudden and fast manner, almost immediately causing the insurer to be in recovery.
3. **Internal:** Where adverse events causing recovery are specific to the insurer itself.
4. **External:** Where adverse events causing recovery are due to the insurer's interconnectedness with a larger group, third-party dependencies or financial markets in general.

These four scenarios are quite distinct from each other and further ensure the completeness of the assessment, both in terms of recovery indicators and options. A slow-moving scenario, for instance, requires an indicator that is forward-looking and signals the insurer of an approaching recovery situation early enough, allowing the insurer to have enough time to prepare for it. A fast-moving scenario, however, occurs overnight and a forward-looking indicator is not of much use there. In this situation the insurer needs to have indicators in place that are triggered and reported as soon as the stress takes place.

The same can be said for recovery options. In an internal scenario, support from the wider group might be a viable recovery option. In an external scenario this might not be the case and alternative options should be explored instead.

When defining appropriate scenarios, insurance companies can get inspiration from existing scenario and sensitivity testing included in for instance the quarterly reporting, SFCR, ORSA, LRMP and SRMP. Business continuity plans can provide insight into the main operational events that can lead to recovery. Although they can be used as a starting point, we do want to stress that recovery scenarios are of a different nature, and separate scenario workshops are likely to be required to determine adequate recovery scenarios for solvency, liquidity and operational risk.

For example, the objective of the ORSA is to prevent an insurer from breaching its SCR and coming under severe stress, whereas a recovery plan envisions the insurer being confronted with severe stress. Recovery scenarios are therefore much more severe in nature than scenarios or sensitivities included in the ORSA and most other reports. As a consequence, key risks and vulnerabilities driving the scenarios can be different as well. Where ORSA scenarios are typically driven by the usual suspects, a recovery scenario can be caused by a risk or vulnerability in an insurer's operations that is, at first sight, insignificant.

Moreover, ORSAs frequently use immediate deterministic stresses whereas recovery scenarios should also contemplate an emerging stress over an appropriate timeframe in order to test the effectiveness of the indicator framework and the usefulness of recovery options under different circumstances. Reverse stress scenarios included in the ORSA could, however, be considered as a starting point for defining scenarios.

FIGURE 3: EXAMPLES OF RECOVERY SCENARIOS INCLUDED IN THE RECOVERY PLAN

SYSTEM-WIDE	INSURER-SPECIFIC	COMBINED
Interest rates scenarios: ▪ Japan scenario (persistently low) ▪ Early 1980s scenario (rates rapidly rising) ▪ Current curve remains the same forever ▪ Reverse yield curve	Operational and strategic: Financial outcome of a significant data breach; bad administrative error; significant drying up of distribution channels	Rapid increase in credit spreads with increased policyholder lapses; call on liquidity coupled with failure of key counterparties
Repeat of 2008-2009 global financial crisis	Analysis of impact of new management strategy, e.g., new product launch	Simply moving everything the wrong way at the same time (and don't necessarily worry about ensuring consistency across risks and maintaining economic theory integrity)
Pandemic plus recession	Insurance risk: mortality/morbidity/lapse	

When comparing all parts of the recovery plan, we feel that the scenario analysis is less important than recovery indicators and options:

- When comparing requirements around the impact and feasibility assessment for recovery triggers and options with the ones for recovery scenarios, one could say that they are similar in nature.
- It is very likely that the scenario causing an actual recovery situation differs from the ones considered in the scenario analysis.
- Because of this, it is unlikely that the scenario analysis can be used as a road map for returning to a going concern status in an actual recovery event. In such a situation it is therefore more important to have an appropriate recovery indicator framework in place as well as having an exhaustive menu of recovery options and their assessments.

Also, we think that in certain cases, and due to their (very) extreme nature, there is a limit as to how much effort should be put into quantifying the recovery scenario impacts on an insurer's balance sheet, for it still to be sufficient for recovery planning purposes.

Let's take the illustrative case where we have a non-life insurer with a Solvency II coverage ratio of 300%. The insurer decides to assess a fast-moving recovery scenario that brings its ratio down to 80%. In case the assessment is done at a high level and the insurer concludes that, to return to a going concern status, they need to reinsure catastrophe risk, cut expenses and get a capital injection from the larger group of €100 million. When the same assessment is done in great detail, the insurer concludes that the capital injection needs to be €110 million instead.

In the end, an insurer should have a thorough understanding of its overall recovery capacity—both in quantum and in speed—after finishing the scenario analysis. The scenario analysis should help them with this. In the above example, the insurer would conclude that it is able to recover, but only if it receives material support from the larger group. This conclusion would not have changed materially when the insurer decided to put a lot of time and effort into quantifying the scenario assessments. In this case, a high-level assessment would suffice for the purposes of recovery planning.

Similar to answering what the overall recovery capacity of an insurer is, scenario analyses are also likely going to result in the identification of gaps and impediments. Including them in the list of pre-emptive measures to be taken further ensures that scenario analyses contribute to the effectiveness, feasibility and timeliness of the recovery options and indicators.

Finally, an insurer's viability also includes being able to enter a solvent run-off, where the insurer permanently closes to new business but continues to honour agreements made prior to that date. As such, insurers should also seek to identify the point at which entering solvent run-off is the most appropriate option unless it would not be a reasonable recovery option under any circumstance. One way of including this in the recovery plan is by assessing the option in a separate, designated scenario in this section.

INFORMATION ON PREPARATORY MEASURES

The ultimate objective of a recovery plan is to enable an insurer to be adequately prepared for a range of possible adverse situations. Recovery planning does not only achieve this by increasing an insurer's understanding of its recovery capacity and its preparedness for adverse scenarios, but it also helps insurers to identify potential impediments to the smooth operation of the governance, processes or timely execution of any planned actions identified.

The objective of this part of the plan is to summarise any such learnings and the proposed actions to improve overall recovery capacity for the future. Examples of impediments identified during the recovery planning exercise could be as follows:

- **Recovery indicators:** Not all processes are in place to report breaches of early warning indicators in a timely fashion. Data required to determine some of these indicators comes from external sources, which poses a risk in adverse scenarios.

- **Recovery options:** There is too much dependency on resources and expertise only available at the larger group, in the event of implementing options in system-wide scenarios that impact the group as well. Some options cannot be implemented within six months without already having preparatory measures in place.
- **Key risks and vulnerabilities identified**: Outsourcing concentrated in a single third-party provider causes unnecessary operational risk exposure. Credit risk that is immaterial in both the business plan, capital and ORSA, can become unresolvable in the case of some extreme system-wide scenarios.

In the above examples, an insurer could for instance choose to split its credit risk and operational risk across multiple counterparties and outsourcing providers. Where the insurer is dependent on the wider group, it can choose to put in place at this point governance, processes and guarantees that can be called upon if there is a stress impacting both the group and the insurer, and the insurer is reliant on group support.

This is what is implied by *preparatory measures*. The CBI expects insurers to reference any preparatory measures as follows:

1. A recovery plan should include details of any preparatory measures that the insurer, or any other entity, has taken or which are deemed necessary to facilitate the implementation of the recovery plan or to improve its effectiveness.
2. Any preparatory measures yet to be taken that are necessary to overcome impediments to the effective implementation of recovery options identified in the recovery plan should include a timeline for implementation.

COMMUNICATION PLAN

In the event of a crisis, proper and thoughtful communication is key to manage and mitigate any potential reputational damage the insurer might face in such a situation. Regulators therefore require that a communication plan is in place for relevant stakeholders, covering both internal and external communications. This part of the recovery plan is also required to show how these communication plans would be implemented at such a time as a recovery plan is implemented.

Dependent on recovery options identified in the plan, it might even be that individual communication plans need to be in place. This is most likely for options with a major impact on the business, such as expense savings programmes or portfolio transfers.

The CBI requires that a recovery plan include an analysis of how the communication and disclosure plan would be implemented when one or more of the options set out in the recovery plan are implemented. This plan might include consideration of the following details:

- Timing of communications
- Frequency of communications
- Contact details required for communications
- Roles and responsibilities of specific people for communications
- Legal responsibilities in relation to disclosure and confidentiality
- Proposals for managing any potential negative market reactions

GOVERNANCE

Governance is an integral part of any well-functioning recovery plan and applies to every step in the planning cycle shown in Figure 1 above. In the recovery planning, governance is typically split into two parts.

- Governance ensuring recovery plans are up to date and aligned with the larger group and its subsidiaries.
- Governance ensuring that recovery planning is an integral part of the insurer’s normal system of governance and overall risk management framework.

Both these categories are to ensure that recovery planning is effective once an insurer finds itself in or close to an adverse situation. It is important that processes are in place ensuring adverse situations are identified early enough and recovery options chosen are feasible, effective and can be implemented in a timely manner.

To further ensure this, the CBI requires a recovery plan to include the following areas:

1. **How the plan is developed and kept up to date:** Processes for developing and updating each section of the plan, control functions involved, criteria for updating the plan to respond to any material changes in the insurer's risk profile, procedures for reviewing and approving the plan and how the plan is communicated to stakeholders.
2. **Alignment with the larger group:** A description of any measures and arrangements taken within the larger group to ensure the coordination and consistency of recovery options at the level of the group and of individual subsidiaries.
3. **Policies and procedures for invoking and implementing the recovery plan:** Internal escalation and decision-making processes, including roles and responsibilities, in the event that the insurer finds itself in an adverse situation. This includes processes to determine which recovery option(s) to implement, escalation protocols and the invocation of a crisis management committee.

Related to the second and third point, the governance section should also include a description of how information and analysis used for preparing the recovery plan is aligned with that used in other governance processes such as the ORSA or business planning. A description of how key functions and existing committees are involved in the review and approval or implementation of the recovery plan, and a description of how the recovery indicator framework is aligned with the relevant KRIs or other early warning indicators used as part of the insurer's regular internal risk management processes should also be included.

Furthermore, an insurer should describe how its internal reporting system and management information systems are able to facilitate recovery planning, including the arrangements in place to ensure that the information necessary to implement the recovery options will be available for decision making under stressed conditions in a reliable and timely way.

It is likely that much of the governance and processes supporting this requirement are already in place or can be integrated into the existing normal day-to-day management processes. Take for instance recovery indicators. Risk reporting already includes regular reporting on KRIs supporting the insurer's risk appetite. Although the recovery plan will likely lead to defining new indicators and triggers, they all can most probably be incorporated into the existing risk reporting processes and reports.

Another example is business continuity planning. To support operational resilience, insurers already have contingency plans and processes in place which can potentially be reused in case of a recovery situation.

Final thoughts

PROPORTIONALITY

Drafting a recovery plan for the first time takes a significant amount of time and resources, especially when covering all regulatory requirements in detail. It is therefore likely that there will be some EIOPA guidelines on simplified obligations with respect to, for instance, the content and the level of detail of the plans.

Realistically, the degree of potential simplification is limited. Although EIOPA indicates that the level of detail within a recovery plan should be appropriate to the scale and complexity of the insurer and should be proportionate, the plan should still be understood on a standalone basis.

In practice this most probably means that parts of the strategic analysis, governance and communication plan, already covered in existing documents and processes, can be downsized by including references to these existing and more detailed documents. Whether this is allowed or not depends on the local regulator. In Ireland, for instance, insurers are not allowed to omit sections by referencing other documents, whereas in the Netherlands it is allowed.

Apart from regulatory requirements, the level of detail to be provided in the recovery plan also depends on the choice of whether to use the plan as a management tool or a compliance exercise. In the latter case the level of detail provided is likely lower than in the former.

PRE-EMPTIVE RECOVERY PLAN VS. ORSA

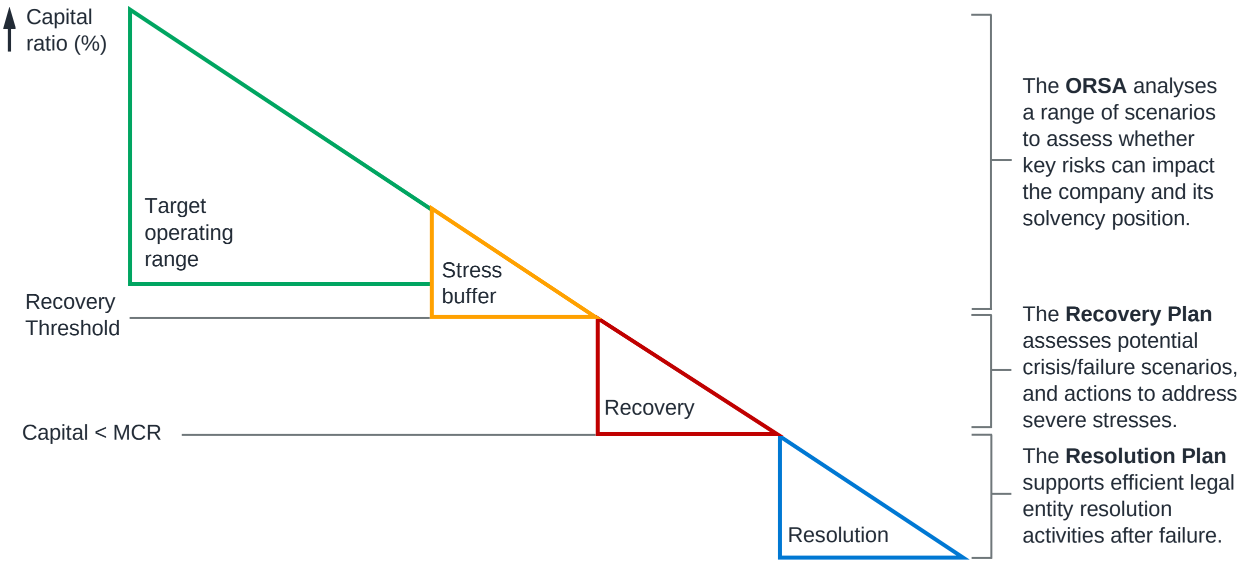
Some of the analyses and results that are part of the ORSA may be similar or, in some cases, may even be sufficient to what is required for recovery planning. Some insurers therefore view the recovery plan as an extension of their existing ORSA process.

In our view the two are fundamentally different. The purpose of the ORSA[11] is to assess the adequacy of an insurer's current and prospective overall solvency needs and related risk management framework. By doing so, the ORSA seeks to *prevent* an insurer from breaching its SCR and coming under severe stress. A recovery plan on the other hand envisions the insurer being *confronted* with severe stress and contemplates the actions needed to mitigate that stress and restore financial strength and viability.

The ORSA focuses on solvency and informs the capital risk appetite by identifying the potential impact of plausible, severe stresses. A recovery plan considers a wider range of causes that might ultimately lead to failure if not appropriately addressed, including solvency, liquidity and operational events.

As a result, the ORSA and recovery plan share similarities, but there are also major differences. Recovery scenarios included to test the feasibility, effectiveness and timeliness of recovery options are, for instance, different in nature from ORSA scenarios. Also, the scope of the recovery plan is broader, the way an insurer's business and operations are assessed is different and thus so are the implications of the plan on the risk management system.

FIGURE 4: SCOPE OF ORSA SCENARIOS COMPARED TO THOSE IN THE RECOVERY PLAN AND RESOLUTION PLAN[12]



MANAGEMENT TOOL OR COMPLIANCE EXERCISE?

When implementing recovery planning for the first time, we see that many insurers focus on getting the plan across the line and getting regulatory approval. Integrating their plans into their normal day-to-day management and risk management framework is not their number one priority.

Some companies that now already have a recovery plan in place, are starting to look beyond merely meeting regulatory requirements and considering how a recovery plan can help support the company's internal enterprise risk management programme, insomuch as it gives focus to how the company will respond in the most adverse of tail risk situations.

[11] EIOPA (14 September 2015). Guidelines on Own Risk and Solvency Assessment (ORSA). Retrieved 18 April 2023 from https://www.eiopa.europa.eu/publications/guidelines-own-risk-solvency-assessment-orsa_en.

[12] CRO Forum (10 February 2023). ORSA Stress and Scenario Testing – Best Practice for Assessing Risks. Retrieved 18 April 2023 from https://www.thecroforum.org/orsa-stress-and-scenario-testing-best-practice-for-assessing-risks/.

Although it is understandable that the number one priority is getting the plan in place, we feel it is important that—when implementing the recovery plan for the first time—insurers make conscious decisions about whether to use the recovery plan as a management tool, or merely see it as a regulatory compliance exercise.

Over the years, the ORSA has evolved into what is now one of the key risk management processes in an insurer's risk management framework. Given its distinct purpose and wider scope, and its interlinkage with many other processes, the recovery plan is well placed to become similarly important and to add significant value to an insurer's risk management framework.

This becomes all the more relevant with the increasing regulatory focus on areas such as operational risk, operational resilience, emerging risks, third-party outsourcing and business continuity management, which are all key inputs for recovery planning. Once implemented, the recovery plan and its regular cycle of reviewing and updating can serve as a "catch-all" of all these processes that feed into it.

Most importantly though the nature of the recovery scenarios forces insurers to evaluate their risk profiles in a way that is different from and much more detailed than what is currently done as part the ORSA process. This allows insurers to see and understand the implications of the risks and vulnerabilities inherent in its business and operations through a range of lenses, from capital requirements through to operational resilience.

The plan can therefore yield some invaluable insights into the operations of the business as an ongoing viable concern, which of course is the focus of executive senior management and the board of directors, and hence can potentially contribute to strategic management decisions. More detail on how a recovery plan can be used as a management tool in an insurer's enterprise risk management (ERM) framework is in a paper we have previously published.[13]

How Milliman can help

Our consultants have been involved in advising our clients on pre-emptive recovery planning for a number of years and have spoken on the topic of recovery and resolution at a wide range of client and industry events. We have undertaken a range of work for clients in this area, including:

- Facilitating recovery planning workshops to identify scenarios to be tested and possible recovery options
- Advising on recovery planning considerations to ensure effectiveness of plans
- Analysing pre-emptive recovery options to ensure effective preparatory measures are put in place
- Designing and implementing of recovery indicator frameworks
- Drafting pre-emptive recovery plans for clients
- Gap analyses of existing plans with the previous draft and finalised guidelines and regulations
- Independent review of recovery plans.

[13] Callaghan, C. & Dardis, T. (August 2022), It's not a recovery plan – it's a management action tool kit, op cit.

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