22 November 2024

BERMUDA MONETARY AUTHORITY

Re: Insurance (Prudential Standards) (Recovery Plan) Rules 2024
Recovery Planning: Expectations and Guidelines

Dear (Re)insurers,

Introduction

On 25 April 2024, the Bermuda Monetary Authority (Authority or BMA) issued the Insurance (Prudential Standards) (Recovery Plan) Rules 2024 (Rules), which are set to take effect on 1 May 2025. In September 2024, the Authority held a workshop with industry to discuss the Authority's expectations in relation to recovery planning. The BMA would like to thank its stakeholders for the continued engagement and feedback provided at the workshop. Adequate preparation in the form of recovery planning not only reduces the probability of (re)insurers failing but also reduces the impact of potential failures by increasing preparedness within (re)insurers. An effective recovery planning framework, therefore, contributes to achieving policyholder protection as well as maintaining financial stability.

In addition to outlining key feedback from stakeholders received during the workshop, this letter summarises the Authority's expectations for recovery planning. It provides practical examples of the challenges (re)insurers face when drafting and implementing a recovery plan. We trust this will be useful for planning relevant activity over 2025, including creating and approving the first Recovery Plans under the Rules through (re)insurer's internal governance. In our future supervisory interactions, the BMA will be keen to discuss the topics outlined in this letter, including how these expectations have been met proportionately to reflect the nature, scale and complexity of each (re)insurer. In this context, 'proportionate' means expecting only the degree of information necessary to understand the key vulnerabilities of an individual (re)insurer (e.g., the vulnerabilities arising from its business model, connectedness, etc.), its recovery capacity (e.g., available recovery options and potential impediments) and the governance arrangements for the development and operation of its plan.

A detailed guidance note on the BMA's expectations and guidelines in relation to recovery planning will be consulted and published in 2025.

Recovery planning and recovery plans

Recovery planning represents more than the production of a recovery plan. Recovery planning involves the active engagement of senior management across the various functions within the organisation that would be critical to the implementation of recovery strategies, as well as engagement from the board and relevant committees. Such engagement is needed to ensure:

- A plausible range of recovery options is identified
- Roles and responsibilities are communicated and agreed upon
- Recovery options are sufficiently challenged for feasibility, impediments and implementation timeframes
- The scenario analysis properly reflects the (re) insurer's strategic objectives in the stress scenarios

- The recovery plan is appropriately tested

Therefore, the recovery plan is a key output of recovery planning and should reflect what has been learned from the process. (Re)insurers are cautioned not to treat recovery planning as a regulatory compliance exercise, as it needs to reflect the (re) insurer's actual processes and business operations.

The Authority would like to emphasise that the Rule's focus is to prompt (re)insurers to carry out an effective recovery planning exercise and not solely to focus on documenting the recovery plan.
The BMA recognises that the objectives of some of the (re) insurer's existing enterprise risk management (ERM) tools, to a certain extent, may overlap with recovery planning, including risk appetites and tolerances, the capital management approach, business continuity and disaster recovery plans, contingency plans and other preventative or corrective measures that the insurer may already have in place. To be effective, the BMA expects recovery planning to be embedded into the (re) insurer's overall risk management framework. Recovery planning assists the (re)insurer in responding to severe stress and restoring financial health, while ERM addresses broader risk identification, assessment, and mitigation. Ensuring the integration of recovery planning within the wider ERM framework aligns the (re) insurer's response to severe stress with its overall risk management strategies. As such, the Authority expects that (re) insurers' current ERM tools will serve as a source of input into the recovery planning exercise. This includes, but is not limited to, the following examples:

- **Trigger framework** – recovery plans are activated when certain metrics breach defined risk tolerance levels. The BMA expects the setting of the (re) insurers' risk appetite limit to be consistent with the recovery plan and serve as a starting point for defining the recovery plan trigger framework

- **Governance** – recovery plans should specify clear governance, detailing who is responsible for activating the plan, overseeing recovery actions and communicating with regulators and stakeholders. The Authority expects (re)insurers to align the governance structure of the recovery plan with that of the ERM framework. The same reporting lines and decision-making bodies should be used to avoid silos and ensure an integrated response during times of stress

A (re)insurer should carefully consider the appropriateness of using some aspects of existing ERM tools and not simply look to replicate existing documentation. In particular, the recovery plan differs from the Commercial Insurer's Solvency Self-Assessment (CISSA) in several ways. The CISSA focuses on assessing a (re) insurer's current and prospective solvency needs and related risk management framework to prevent it from breaching prudential and regulatory requirements and coming under severe stress. On the other hand, the recovery plan envisions the (re)insurer being confronted with severe stress and contemplates the actions needed to mitigate that stress and restore viability. While the CISSA predominantly focuses on risk management and solvency and informs risk and capital management by identifying the potential impact of plausible but severe stresses on the level of solvency, a recovery plan should be a more holistic document and consider a broader range of causes that might lead to stress events, including market-driven liquidity and operational events.

Scope and application

The Authority shall require formal recovery plans to be compiled by (re)insurers that are assessed to be economically important, systemically significant or at risk of posing a threat to the financial stability of

Bermuda should they fail. In assessing if a (re)insurer is economically important or if its failure could pose a threat to the financial stability of Bermuda, the Authority will, among other things, take into consideration the class of registration, size or market share, external and internal interconnectedness, complexity, business model, risk profile, substitutability and the cross-border activities of the (re)insurer. Alternatively, at its discretion, the BMA may require (re)insurers to take recovery planning steps as necessary (for example, evaluating specific risks and options in possible recovery scenarios) without compiling a formal standalone plan. (Re) insurers that fall within the scope of the Rules will have received a formal notification from the Authority.

Group recovery plan

It is the Authority's expectation that when a Bermuda (re)insurer is included in a recovery plan required by and filed with a group-wide supervisor, the (re)insurer may make a written application to the BMA to adopt that recovery plan instead of creating a separate plan under the Rules. This includes when the group-wide supervisor is the BMA.

The application should accompany a copy of the recovery plan filed with the relevant supervisory authority and request approval to adopt that recovery plan instead of creating a separate plan under the Rules. Where the BMA is satisfied that the recovery plan meets the requirements of these Rules, the Authority shall approve the application and notify the (re)insurer of its decision in writing. In the event that the BMA requires a (re)insurer to prepare a separate entity-level recovery plan, the Authority will aim to cooperate and coordinate with the group-wide supervisor (if the BMA is not the group-wide supervisor) to prevent inconsistencies in actions and the execution of the recovery plan during times of crisis.

Ownership and accountability

Recovery planning should be integrated into the (re) insurer's overall ERM framework and should be evaluated, developed, maintained and owned by the (re)insurer. Where outsourcing is used to help a (re)insurer develop its recovery plans, the (re)insurer should have demonstrable oversight and clear accountability for the outsourced service to the same degree as it would if recovery planning was performed internally and subject to the insurer's own standards of governance and internal controls. In practice, (re)insurers must ensure that outsourcing does not compromise the quality and effectiveness of recovery planning.

In cases where the development of the recovery plan has been outsourced, it should be noted that this does not take away the responsibility from the (re) insurer's management and board. Accountability cannot be outsourced. A (re)insurer's senior management and board shall be accountable for developing, maintaining and implementing the recovery plan in line with the Authority's expectations detailed in this letter.

Contents of the recovery plan

The BMA recognises that the recovery plan is a living document. It should be periodically tested for ongoing effectiveness and updated, including in the event of material internal or external change that could render it insufficiently effective. Areas for further improvement should be identified along with an outline of a schedule to address them. Regardless of any future changes, every effort should be made to ensure that the initial version of the plan submitted to the BMA is both plausible and well-founded.

Executive summary

The objective of a recovery plan is to allow the board and senior management to promptly understand and assess triggers, recovery options and communication strategies for effectively responding to any severe stress situations. Therefore, the Authority expects the executive summary of a (re) insurer's recovery plan to include, at a minimum, the following topics:

- High-level overview of the main components of the plan
- Most significant triggers
- Key recovery options
- Operational plan for implementation
- Any key updates/changes to the recovery plan

Description of Insurer

The Authority expects the (re) insurer's recovery plan to include a high-level description of the (re)insurer, including:

- (Re) insurer's business and risk strategy
- Organisational structure – both operating and legal structure
- Key jurisdictions in which the (re)insurer is active
- Entities covered by the recovery plan
- Key services and critical business functions
- Key dependencies or inter-dependencies

Trigger framework

The trigger framework should include a range of criteria, each with established limits and thresholds, that will prompt certain responses from the (re)insurer, such as enhanced monitoring or implementation of the recovery plan.

The framework may include quantitative criteria such as capital, liquidity, profitability, interest rate movements and fluctuations in business volumes or qualitative criteria such as asset quality, macro-economic conditions, and operational events (e.g. cyber-attacks). The criteria should consider company-specific metrics as well as economic metrics.

The framework should operate in a tiered manner to reflect that varying degrees of response will be required, depending on the circumstances and severity of the stress event. For instance, an insurer may use certain criteria as 'early warning indicators' to alert it to emerging risks and determine that these criteria require heightened monitoring. Other criteria may be used as 'trigger points' for enacting more intensified responses, such as starting escalation procedures or activating the recovery plan.

(Re)insurers should monitor a similar set of metrics in recovery planning and contingency planning to ensure consistency in risk monitoring throughout the organisation. For instance, the criteria monitored as part of recovery planning are expected to align with those in the CISSA, as well as the capital and liquidity policies. Metrics should be integrated into a (re) insurer's wider Management Information System to enable regular monitoring by the (re)insurer.

Recovery options

Recovery options are a range of potential actions that (re)insurers can take, for example, to improve their capital/liquidity position or take operational actions to recover from extreme stresses. In the event that recovery triggers/indicators are breached, recovery option(s) may be implemented.

Recovery options would typically include actions to:
- Raise capital or other funding
- Increase liquidity
- Implement business continuity or disaster recovery plans
- Enhance risk mitigation, e.g., expanded use of reinsurance
  Reduce costs

When selecting recovery options, consideration should be given to the financial impact of the option, the speed and timing of the implementation, the feasibility and suitability of the option and any implementation constraints. It is also important that any recovery option should be underpinned by realistic assumptions, particularly in relation to pricing and valuation, to properly reflect that the option would be implemented in circumstances of severe stress.

The options selected should be suitable for the business model of the (re)insurer. (Re)Insurers should select options that are implementable in a stressful situation and help mitigate the impacts of the stress event. However, (re)insurers should also consider options that are not as easy to implement, such as structural changes, especially for options in response to extreme stress situations. (Re)Insurers should also develop a plan that considers any implementation constraints associated with each option and how to address them. For example, it can be distinguished between the time needed to execute an option and the time needed to realise its benefits (if there is a difference).

Consideration should also be given to the compatibility of the options by taking a holistic review of all the recovery options available and considering which options will be prioritised, what order recovery actions will be taken, which options can be combined and the potential impact of options on each other once implemented. The recovery options should be developed independently of any specific stress scenarios. Scenario analysis should then be employed to help assess whether the recovery options provide sufficient capacity for recovery across a range of potential stresses and whether they can be implemented in a timely manner.

Scenario analysis and operational testing

Scenario analysis is performed to test the credibility and effectiveness of the plan. The scenarios should be calibrated to reflect events that could threaten the insurer's stability unless recovery options are implemented in a timely manner. Hence, the scenarios will typically be based on events that are exceptional yet plausible and varied enough to test whether crisis indicators would be picked up. For example, a scenario may be calibrated to breach the BSCR requirements. The scenarios should reflect the company's business model and the Bermuda (re)insurance market specifics. It is important to note that the scenarios used for recovery planning should be more severe than those used for CISSA (except for reverse stress testing).

The analysis of each scenario should set out which recovery indicators would be triggered and at what point. (Re)Insurers should also set out which recovery options would be implemented in each of the scenarios, as well as the expected impact, feasibility and timeframe of implementation. (Re)insurers should evaluate each scenario impact, among other things, on liquidity, capital, profitability and risk profile while considering the impact of recovery options activated in response.

In developing the scenarios, (re)insurers should take into consideration the following:

- Idiosyncratic versus systemic – include at least one scenario specific to the (re)insurer and another that affects the broader industry or economy. Consideration should also be given to the combination of both an idiosyncratic and market-wide stress event. This will enable (re)insurers to evaluate recovery options under various circumstances and identify any potential constraints that may arise

- Fast versus slow – include at least one scenario that evolves quickly (for example, a sudden reduction in the market value of investments) and another that evolves over a longer period of time (for example, ongoing trading losses), as each of these are likely to require a different recovery response

- Operational – at least one scenario should be included that covers an operational event, such as a cyber-attack

Scenario analysis should be supplemented by operational testing or simulation exercises to serve as 'dry runs' of the recovery plan. These exercises are essential for assessing the practical effectiveness of the plan and providing assurance that it can function as intended during any future potential management crisis or stress scenario. Plans of this nature and their scheduled timing should be detailed in the recovery plan. The recovery plan should then be revised after the simulation is completed. The operational testing of the recovery plan process is important to build confidence that the governance and escalation procedures in the plan are well understood, including by the board and senior management. This provides assurance that the recovery plan can be implemented in a timely manner during a crisis. Thus, (re)insurers should consider conducting regular simulations/ dry runs focusing on the internal escalation processes, the formation and functioning of crisis management teams and determining communication strategies.

Proactively testing the recovery options and assumptions detailed in the plan assures management that the plan can be effectively executed in a crisis.

Governance and communications

In this section, the (re)insurer should set out the organisation's current governance structure, including specifics in relation to crisis management. The plan should describe the processes for monitoring, escalating and activating the recovery plan, as well as the key roles and responsibilities of the relevant stakeholders in each area of the governance process. There should be a committee responsible for activating and leading the implementation of the recovery plan that the board assesses and approves.

The (re)insurer should establish suitable policies for continuously developing and reviewing the recovery plan. The plan should be reviewed and updated at least once every three years or when there is a material change in the company's financial position, strategy, business or risk profile. The Authority may require more frequent updates, which (re)insurers will be informed of in writing.

The (re)insurer will also need to anticipate the potential communication needs during a crisis and develop a plan for addressing these. This should be based on the communication plan in any existing contingency planning framework.

Typical challenges encountered

The Authority recognises that performing an effective recovery planning exercise and drafting the recovery plan poses several challenges. Examples of typical challenges observed from entities in other jurisdictions when drafting and implementing their recovery plans are outlined below.

Lack of focus on practicality

Recovery plans should be specific to the entity, considering its structure, risk profile, business model, cross-border activity, size, etc. Although writing a recovery plan may initially be seen as a theoretical document, it should be designed as a usable, practical document for times of stress. The recovery plan should be designed so that it can be executed by the entity, and any assumptions made about its ability to execute it should be realistic, plausible and clear to the users.

Disproportionate focus on scenarios

The primary purpose of the scenarios is to validate the viability and test the impact of the recovery options available to an entity. Though the scenarios should be credible and extreme and consider a range of circumstances, they are not the core element of the recovery plan. (Re)Insurers should be mindful of the role of the scenarios and not give them disproportionate focus at the expense of other areas of the recovery plan, particularly the option analysis.

Inadequate option analysis

As noted above, the recovery options are the core of the recovery plan. The recovery options should be able to prompt recovery from severe financial stresses in isolation or in concert. (Re)insurers should ensure that, in practice, the options can be utilised during the time that the firm is experiencing a stress scenario. (Re)insurers should also adequately consider the speed at which options can be exercised and the financial impact of the options in different scenarios to ensure both are sufficient to enable (re)insurers to recover.

Theoretical governance structure

The governance structure considered in the recovery plan (i.e., the reporting lines, frequency of information and owners of key decisions) should reflect the company's reality. If a separate governance structure would work better in a recovery scenario to enable quicker decision-making in a crisis, it should be realistic, practical and feasible for (re)insurers to implement. Moreover, it is essential to consider methods for evaluating this governance.

Optimistic approach to impediments/obstacles

When determining the recovery options available to the company and evaluating them, (re)insurers should also consider whether there are any potential obstacles (e.g., regulators, market conditions or availability) that could exist in a stress scenario that could prevent the firm from exercising its options. Considering these obstacles, (re)insurers should make realistic or prudent assumptions when determining their recovery options.

Inappropriate calibration of triggers

Triggers are metrics that should indicate when a financial stress is reached or forecast. Triggers are less useful if they are frequently activated in business-as-usual circumstances, as they may not effectively indicate potential or actual financial stress. Similarly, if the triggers are not calibrated to activate in a particular scenario, the (re)insurer may not become aware of the potential financial stress and the need to execute recovery actions in a timely manner. There should be a focus on forward-looking indicators rather than a reliance on lagging indicators to enable the company to take preventative action.
Other challenges include the following:

- Lack of consideration of how to maintain and enhance the plan in future
- Too many immaterial or infeasible options are included
- Disjointed documentation with inconsistent messages or themes

Next steps

A detailed guidance note on the BMA's expectations and guidelines in relation to recovery planning will be consulted and published in 2025.
The Authority would like to thank stakeholders once again for their feedback. The BMA remains committed to working with stakeholders and other interested parties to ensure the optimal protection of policyholders and that the results achieved are in the best interest of the Bermuda market. Any stakeholder seeking further clarification or requiring additional information on these matters should contact the Authority directly at riskanalytics@bma.bm.

Sincerely,

Gerald Gakundi

Deputy Managing Director – Head of Insurance and Investment Funds