

Identification of Critical Functions of Insurers

Practices paper

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Executive summary

The identification of critical functions is an important part of resolution planning, which is often conducted as a first step to help inform appropriate resolution strategies. It has therefore been discussed in detail in FSB guidance and preparatory work. During recent years, FSB member jurisdictions have started developing their frameworks for the resolution planning of insurers and the identification of critical functions of insurers and acquired first practical experiences.

This Practices Paper describes and discusses the approaches chosen by four jurisdictions for the identification of critical functions of insurers. Each have developed policy for, or significantly progressed their thinking on, the identification of critical functions in their jurisdiction. These case studies set out the approaches taken by Australia, China, France and the Netherlands and describe commonalities and differences in background, scope, methodology and review process. The paper also informs about the main critical functions which were identified and the main considerations which supported the identification, providing an illustrative example for each jurisdiction.

The four jurisdictions which contributed their case studies all appear to apply the three elements of assessment developed by FSB guidance: the assessment of the impact on financial stability and real economy; the assessment of substitutability; and the insurer-specific assessment. However, the sequence of these steps and the context in which the assessment is performed vary amongst the jurisdictions. For example, in China, the insurers themselves prepare a self-assessment which is then validated by the authorities. In the Netherlands, the public interest test includes considerations similar to the criticality of functions. France identifies functions which are critical by nature and then identifies the most significant insurer with regard to each of these functions.

The case studies mainly identify critical functions in relation to insurance payments that are vital to individuals' financial security and where insurance coverage is a precondition for individuals to go about their daily lives or where insurance coverage is a precondition for economic activity. It appears that authorities have used a broad interpretation of the definition of critical functions, having regard to the economic and social function of insurers. Critical functions in relation to investment and lending to the real economy and to acting as a counterparty in derivatives, repo and securities lending markets appear to be of less relevance or seem to be limited to the Chinese example.

The examples indicate that there is a large variety of considerations which may support the criticality of insurers' functions for the financial stability and the real economy. This appears to correspond to the large variety of products and functions of insurers. The methodology and considerations shared in the case studies could be interesting examples for authorities in other jurisdictions that are yet to develop, or are in the process of developing, their critical functions policy or assessment method.

Introduction

The Key Attributes of Effective Resolution Regimes for Financial Institutions (the KAs) set out the core elements that the FSB considers to be necessary for an effective resolution regime. Their application should allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss from solvency support and maintain continuity of their vital economic functions.¹ The identification of these critical functions is therefore a core part of resolution planning and often conducted as one of the first steps to build the basis for further planning decisions

Critical functions have been discussed in detail in FSB guidance and preparatory work, such as FSB's guidance on Developing Effective Resolution Strategies and Plans for Systemically Important Insurers (the Resolution Planning Guidance).² The FSB consulted publicly on Guidance on Identification of Critical Functions and Critical Shared Services (the Consultative Document).³ These topics have also been considered in FSB's Key Attributes Assessment Methodology for the Insurance Sector (the Assessment Methodology).⁴

During recent years, FSB member jurisdictions have started developing their frameworks for the resolution planning of insurers and the identification of critical functions of insurers. This Practices Paper (the Paper) presents how four FSB member jurisdictions are approaching the identification of critical functions of insurers. Each have developed policy for, or significantly progressed their thinking on, the identification of critical functions in their jurisdiction. The Paper sets out the approaches taken by Australia, China, France, and the Netherlands, and commonalities and differences regarding the following elements:

- background;
- scope;
- methodology;
- an illustrative example;
- review process; and
- list of critical functions and main considerations.

These points were addressed by all four FSB member jurisdictions in light of the current status of their regulatory framework and practical implementation, which is reflected in different areas of focus and different levels of detail chosen by each jurisdiction. This Paper therefore does not offer a comprehensive description or comparison but may provide an impression of how the four example jurisdictions have approached the identification of critical functions.

¹ FSB (2014a), *Key Attributes of Effective Resolution Regimes for Financial Institutions*, October.

² FSB (2016), *Developing Effective Resolution Strategies and Plans for Systemically Important Insurers*, June, p.14.

³ FSB (2014b), *Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services*, October.

⁴ FSB (2020), *Key Attributes Assessment Methodology for the Insurance Sector*, August, p. 3.

The Paper starts with an overview over FSB's guidance and preparatory work regarding the identification of critical functions of insurers in section 1. Section 2 presents the case studies. Section 3 and section 4 summarise the main considerations and assessment methodologies used in the case study jurisdictions. Conclusions are presented in section 5.

The Paper endeavours to share knowledge and experience. It will be relevant to supervisory and resolution authorities in other jurisdictions that are yet to develop, or are in the process of developing, their critical functions policy or assessment method.

1. Identification of Critical Functions

The identification of critical functions is an important part of resolution planning, which is often conducted as a first step to help inform appropriate resolution strategies and public interest tests. The identification of critical functions therefore determines scope and depth of resolution planning for insurers. For example, it will guide assessments of internal and external interconnectedness, measures to ensure continuity and the choice of resolution tools.

Critical functions and the continuity of insurance have been the subject of FSB's policy work as well as of the practical resolution planning undertaken by authorities. They are an important part of the Resolution Planning Guidance, the Consultative Document, and the Assessment Methodology.

Pursuant to the Resolution Planning Guidance, a function of an insurer is critical if it has all of the following three elements:⁵

- it is provided by an insurer to third parties not affiliated to the firm;
- the sudden failure to provide that function would be likely to have a material impact on the financial system and the real economy (for example by giving rise to systemic disruption or by undermining general confidence in the provision of insurance); and
- it cannot be substituted within a reasonable period of time and at reasonable cost.

The methodology developed by the Resolution Planning Guidance and the Consultative Document to guide authorities in the identification of critical functions entails the following three steps which do not necessarily have to be performed in the presented order:⁶

- **Step 1 - Impact Assessment:** an analysis of the impact of the sudden discontinuation of the function;
- **Step 2 - Substitutability Assessment:** the evaluation of the substitutability of the function (market analysis); and

⁵ FSB (2016), p. 15.

⁶ FSB (2016), p. 15; FSB (2014b), p. 5.

- **Step 3 - Firm Specific Test:** a firm-specific analysis of the impact of a failure of the continued performance of the function by a specific insurer.

To support the application of this methodology, the Resolution Planning Guidance describes basic considerations for the assessment of the three steps.⁷ The Consultative Document includes further details to support this assessment and seeks to assist home and host authorities in meeting the recovery and resolution planning requirements under the FSB KAs by:

- assisting in their evaluation of the criticality of functions that firms provide to the real economy and financial markets; and
- promoting a common understanding of which functions and shared services could be critical by providing common definition and evaluation criteria.

Against this background, the Paper presents the practical approaches chosen by four jurisdictions for the identification of critical functions of insurers and discusses the extent to which the preparatory work in the Resolution Planning Guidance and the Consultative Document have proved to be useful for these practices.

2. Case Studies

The Australian authorities conducted an interim system-wide impact and substitutability assessment to identify potentially critical functions. An insurer-specific assessment of critical functions has not yet been undertaken.

Box 1: Identification of Critical Functions in Australia

Background

The Prudential Standard CPS 900 Resolution Planning (**CPS 900**)⁸ requires APRA-regulated entities that are Significant Financial Institutions (**SFIs**)⁹, or those that otherwise provide critical functions, to support APRA in the development and implementation of a resolution plan.¹⁰

CPS 900 aims to ensure that APRA-regulated entities can be resolved by APRA in an orderly manner. In such circumstances, the aim of resolution is to protect beneficiaries, minimise disruption to the financial system, and provide continuity of critical functions.

APRA has conducted an interim system-wide assessment to evaluate the impact of discontinuation of various functions on both existing and prospective policyholders and financial system stability.

The interim assessment sought to identify which functions in the market were potentially critical, and should be preserved in resolution (e.g., by ensuring the insurer continues to write new business through recapitalisation or transfer strategies rather than executing its solvent run-off plan or maintained temporarily to facilitate substitution over time). This was achieved by conducting an impact assessment

⁷ FSB (2014b), p. 9, Annex.

⁸ CPS 900 comes into effect on 1 January 2024.

⁹ For insurers, an SFI is defined as having assets greater than \$10bn for General and Life Insurers, or greater than \$3bn for Private Health Insurers, or is determined as such by APRA having regard to matters such as complexity in its operations or its membership of a group.

¹⁰ CPS 900 defines critical functions as any function provided by an APRA-regulated entity that is important to financial system stability or the availability of essential financial services to a particular industry or community.

and substitutability assessment for the different lines of business in Australia. A formal assessment will be conducted at an individual firm level by incorporating a firm specific test as part of resolution planning.

APRA has commenced the resolution planning process for some insurers and will conduct a formal assessment of critical functions as part of that process.

Scope

The interim assessment considered all lines of business for both general insurance and life insurance underwritten in Australia, with some lines of business broken down into sub-categories (for example, professional indemnity was broken down into key industries). When conducting the firm specific assessments, APRA will also assess other types of services insurers provide.

Methodology

APRA sought to answer the following high-level questions with the support of the latest market data:

1. What is the potential **impact** of the discontinuation of the function both on customers and the wider financial system / real economy?
2. What is the level of **substitutability** within the market for that function (inc. timing and cost, or barriers to entry in the market)?
3. What is the insurer's **market share** for the function (inc. geographical concentrations)?

The methodology consisted of two parts:

- 'Function-specific analysis', considering individual functions (i.e., business lines) in their own right. In particular, considering the impact of failure on both policyholders and the wider financial system and real economy, and substitutability.
- 'Concentration analysis', considering the provision of that function by a specific insurer, taking into account its market share and other considerations relevant to that insurer.

Data was used from industry lodgements to come to an initial view on criticality. At times this data lacked the granularity to be sufficiently informative given the aggregated way information was collected on particular product lines.

Illustrative example

As an example, the assessment considered that professional indemnity insurance for the medical profession was likely to be a critical function:

- **Function specific analysis:**
 - The impact on the policyholder was considered to be high. It is a mandatory requirement from professional associations to have indemnity insurance coverage in order to practice.
 - The impact on the real economy was considered to be high. An insurer failing could lead to some medical professionals being unable to practice, potentially resulting in cancellation of medical procedures and patients unable to seek treatment and flow on effects for the broader health system.
 - The substitutability was considered to be average. There were other players in the market offering similar products and substitution could be possible in a reasonable timeframe.
- **Concentration analysis**
 - There was one insurer with c.50% of the market share and a number of insurers with smaller shares. The extent of substitutability would likely be dependent on the insurer.

Review Process

An internal working group reviewed the available data and substantiated gaps in knowledge through anecdotal experience. In this way an initial view on potential critical functions in the market was identified which would be a foundation for further detailed assessment.

List of Critical Functions and main considerations.

A formal assessment has not yet been conducted.

The process of identification of critical functions in China follows a “bottom-up” approach. Insurers are required to evaluate their own financial service and products and analyse a broad range of factors to identify critical functions as part of their recovery and resolution planning. As insurers differ a lot in their products and services, the functions that have been identified as critical are diverse.

Box 2: Identification of Critical Functions in China

Background

Identification of an insurer’s critical functions in China can be traced back to 2013, when Ping An Insurance (Group) Company of China, Ltd. was identified as a Global Systemically Important Insurer (G-SII). Since then, Ping An Group has been formulating and updating recovery and resolution plans every year under regulatory guidance. The identification of critical functions was an indispensable part of the progress.

China’s regulation authorities keep imposing rules and regulations to strengthen the prudent operation of financial institutions, and to enhance their ability to mitigate and resolve financial risks. In 2021, the China Banking and Insurance Regulatory Commission (CBIRC) issued the Interim Measures for the Implementation of the Recovery and Resolution Plan for Banking and Insurance Institutions (hereafter Interim Measures), providing guidelines for banks and insurers to formulate recovery and resolution plans, including the identification of critical functions.

Scope

Insurers subject to recovery and resolution plans need to identify their own critical functions. According to the Interim Measures, insurance institutions with total on-balance sheet assets on a consolidated basis at the end of the previous year reaching **RMB 200 billion** (including foreign currency equivalent), or **designated by the CBIRC and its local offices** in view of their business characteristics, risk profiles and spill over effects, should formulate recovery and resolution plans. In addition, if an insurance group (holding) company and its affiliated insurance institutions both meet the above criteria, the insurance group (holding) company shall, in principle, formulate **unified** recovery and resolution plans. Currently, dozens of insurers have already been subjected to the recovery and resolution plans requirement.

Definition

In the Annex of the Interim Measures, critical functions are defined as critical financial services provided to third parties, and sudden interruption of these financial services would have a material impact and likely cause contagion or panic in financial market. Insurers’ major financial products and services typically include insurance underwriting, claim settlement, insurance preservation, capital markets and investment activities, etc. In addition, insurers may subdivide the above products and services based on their own business considerations.

Methodology

In China, the identification process of critical functions follows a “**bottom-up**” approach. Specifically, when identifying their own critical functions, insurers need to evaluate their own financial services and products, analysing a broad range of factors such as business scale, number of customers, market impact, substitutability, etc., incorporate their identification results in recovery and resolution plans, and

submit them to regulation authorities for review and approval. Insurers differ a lot in their products and services, leading to diverse identification results.

Illustrative example of application of methodology

The following illustrative example shows how insurers in China perform their identification analysis based on different factors:

- When conducting business scale analysis, insurers may consider factors such as market share, the ranking of market share, etc.
- When conducting substitutability analysis, insurers may consider factors such as number of service providers in the market, market concentration, number of customers, etc.
- When conducting impact analysis, insurers may consider whether the failure of the function would have significant impact on customers, and the possibility of contagion, including whether it will have significant impact on capital markets.
- Some insurers also conduct internal importance analysis, based on whether the percentage of profit contribution reached certain criteria, and the interconnectedness between the function and other financial functions of the insurer or the group.

After finishing the analysis of each factor, insurers may use different approaches to obtain final identification results. Some insurers use a simple **pass/fail test** on each criterion; a critical function should pass all pass/fail tests. Other Insurers may adopt a more quantitative “**scoring**” approach, computing a weighted sum of scores on each criterion; functions with final scores exceeding certain threshold are identified as critical function.

Illustrative example of identification results

Insurers in China are differentiated by size, business structure and market specialisation, leading to diverse critical results. The following shows an incomplete list of some insurers’ identification results:

- **Insurance functions** as critical functions: insurance underwriting, claim settlement, insurance preservation.
- **Insurance products** as critical functions: vehicle insurance, agriculture insurance, ordinary life insurance, participating insurance, universal insurance.
- **Insurers’ non-insurance activities** as critical functions: banking, capital market activities.

In summary, identifying critical functions is a new task in China. Given the vast business differences between insurers and the “bottom-up” identification approach, it is generally not possible to summarise all critical functions in one single list.

The French authorities start by defining a list of functions that are deemed to be of critical nature. In a second step, they identify the most significant insurers or insurance groups for each of these activities that are deemed critical by nature.

Box 3: Identification of Critical Functions in France

Background

According to the French regime¹¹, ACPR shall establish a pre-emptive resolution plan for each of the insurance groups subject to the pre-emptive recovery plan requirement, that is to say for each insurance

¹¹ ACPR (2020), *Identification of the critical functions of insurance undertakings*, December.

undertaking of which the total assets exceed the EUR 50 billion threshold (at least once in the last three financial years).

At this stage, ACPR has started to develop first plans, which focus mainly on the identification of potential critical functions carried out by the insurance groups on the French market, and on resolution measures and tools aimed at maintaining these functions, when appropriate.

The approach builds on the international-level principles developed by the FSB, and on the interactions with the insurance groups.

Scope

In practice, the identification of critical function is systematic for the 14 insurance undertakings that are subject to the pre-emptive recovery plan requirement. The scope of the assessment included all of the existing insurance categories listed in article A.344-2 of the French Insurance Code.

In addition, ACPR can also require other insurance groups to be subject to recovery and resolution planning, even if their balance sheet is under the EUR 50 billion threshold. Indeed, ACPR can assess that those insurers provide critical functions or that their activities would present specific risks in case of disruption, after an adversarial debate between the Supervisory College and the insurer in question (article L311-5 of the French Insurance Code). Since 2022, this has been applied to two insurance undertakings, in addition to the other 14 mentioned before.

Methodology

The methodology comprises two steps:

1. The definition of a list of functions deemed critical due to their nature: **similar to FSB's approach, which lists "possible critical functions" in the annex of the guidance on identification of critical functions** (Consultative Document)¹². FSB considers the step as a way to identify functions, which "conceptually could have an adverse effect on financial stability and the real economy". However, ACPR considered that the two effects on both financial stability and real economy **should not be cumulative but alternative** in order to broaden the pre-emptive resolution regime to insurers with potentially small effects on financial stability, but whose failure would lead to significant impact on the real economy.
2. The determination of a criticality threshold intended to identify, for each of these activities, the most significant insurance undertakings and groups.

The first step consists of defining a list of functions that are deemed to be of critical nature and is derived from:

- The analysis of the activities' characteristics (whether the insurance is compulsory or not, whether it provides long-term/short-term guarantees etc.).
- The assessment of the impact which the insolvency of an entity would have on the real economy or on financial stability (without taking into account elements of substitutability);
- The analysis of substitutability at a reasonable cost and within a reasonable time.

Impact assessments and substitutability analyses for the criticality of a function are carried out assuming that an entity is failing, without examining the circumstances and scenarios that could have led to the failure of that entity.

The second step is intended to identify the most significant insurers or insurance groups for each of the activities that are deemed critical by nature. The criticality threshold is set at a 10% market share. The application of the criticality threshold might not be automatic. The definition of the degree of

¹² [Consultative Document](#)

criticality could also involve an expert judgement component, making it possible, on the basis of a case-by-case analysis, to include, for a given undertaking or group, an activity despite a market share below the set threshold (or, conversely, to exclude an activity despite a market share above 10%).

Illustrative example of application of methodology

As for example, savings activities have been presumed critical based on the following rationale:

- **Impact analysis**
 - Impact of a breach of protection is medium, with a decrease in saving rates and loss of the tax benefit resulting from contract maturity. Breach of protection can also have spill over effects, with reputational risks and massive withdrawals for all life insurers.
 - Impact of an inability to comply with commitments is significant, with a loss of accumulated capital for unit-linked insurance (risk of loss is usually accepted by the policyholder when the contract is signed), with spill over effects for example though an impact on the financial market in the event of a mass selloff of assets.
 - Overall, the impact on real economy or financial stability is significant.
- **Substitutability analysis**
 - Although euro and unit-linked savings activities represent a highly competitive market and standardized products, the market has players with substantial market shares associated with massive volumes. There exist guaranteed yield contracts and a low profitability of the portfolio in a context of rising interest rates.
 - Overall, substitutability is considered to be on a medium level.

Review process

The identification of critical functions is an iterative process, and this first approach may be subsequently amended and supplemented, based on the additional information that may be collected and further analyses that may be carried out.

List of Critical Functions and main considerations

Based on the methodological principles, six functions are deemed of a critical nature in France:

- savings, in euro and unit-linked;
- motor vehicle including civil liability;
- medical liability;
- construction;
- agricultural insurance; and
- credit insurance and bonding.

The main considerations are set out in section 4 of this note.

The Dutch authorities assess in a public interest test whether the resolution objectives can be better achieved in resolution as compared to regular insolvency proceedings. In this context, assessing the significant impact of the failure of an insurer on society, financial system, or economy could possibly allow conclusions for the identification of critical functions as well.

Box 4: The public interest assessment for insurers in the Netherlands

Background

The Dutch regime for resolution of insurers does not explicitly aim at protecting critical functions of insurers. Instead, its objectives are:

- A. the protection of policyholders;
- B. the prevention of great negative impact on society;
- C. the prevention of significant impact on the financial system or the real economy; and
- D. the prevention of the use of public money.

With the public interest test DNB assesses whether these objectives can be better achieved in resolution as compared to regular insolvency proceedings. One could argue that significant impact of the failure of an insurer on society (objective B), financial system, or economy (objective C) implies that this insurer performs a critical function.

Scope and timing

DNB assesses the public interest in several instances, for a different scope of insurers, on different levels of granularity:

- Every year for each insurer with a regulatory permit (Solvency II) DNB assesses whether objective B (impact on society) or C (impact on the financial system or real economy) could be at stake in case it fails. If so, the insurer is eligible for resolution planning.
- For those insurers eligible for resolution planning, the added value of resolution for all four resolution objectives is assessed in greater detail in the resolution plans.
- At the point of failure this is done again, taking into account the circumstances of the insurer, the sector, economy, and society of that point in time.

The four resolution objectives are not ranked, but in the public interest test the objective of policyholder protection (objective A), should always be considered in conjunction with one of the other three objectives (B, C, D). In contrast, achieving one of the objectives B, C or D can be a sufficient condition to take a failing insurer into resolution (i.e., positive public interest test). Therefore, the two objectives that can be associated with critical functions (B and C) justify by themselves a positive public interest test.

Methodology

For each resolution objective assessment indicators have been identified. For the objectives that are most relevant for the critical functions of insurers, these include:

Objective B: size of the insurer, type of insurance products, type of policyholders, expected shortfall at failure.

Objective C: size of the insurer, interconnectedness with the financial system, impact on consumer confidence in the financial and insurance sector, and substitutability in specific (niche) sectors.

These indicators are individually scored on a quantitative, and/or qualitative basis. The conclusion on whether the public interest is at stake, is drawn based on the total picture of these individual scores, complemented by expert judgement. For some indicators the Dutch law provides indicative thresholds: e, g. technical provisions exceeding EUR 1 billion or the number of policyholders exceeding 1 million indicate that the size of the insurer is large enough for resolution to be in the public interest.

Outcome and illustrative examples

In the past three years DNB identified between 10 and 15 insurers/insurance groups that are eligible for resolution planning. The resolution plans detail for each insurer (in the group) which indicator triggers the public interest of resolution, thereby hinting at critical functions. Examples include:

- The largest five insurance groups exceed the indicative thresholds of the size indicator, and they (among others) provide pension products, upon which policyholders rely for their livelihood. As a result, the failure of these insurance groups could have undue impact on society (objective B).
- A few small non-life insurers provide insurance cover in specific niche markets, with a significant market share in these markets. Failure would leave policyholders without the possibility to insure their risks, given limited substitution options. Examples include medical liability insurers and insurers covering climate related damage (objective C).

Review process

The list with insurers eligible for resolution planning is reviewed every year. The resolution plans, including the public interest assessments, are reviewed at least every three years.

3. Main considerations for the assessment of Critical Functions

3.1. Main considerations per type of insurance

The practical approaches described by the four jurisdictions for the identification of critical functions of insurers explain some of their considerations with a view to different types of insurance. These considerations resonate with the technical background provided by FSB guidance and the Consultative Document which looked into the variety of possible considerations and developed details for each type of economic function of insurance. The Consultative Document explains how the relevant considerations for the assessment vary depending on the type of insurance and the economic function that this type of insurance performs in a jurisdiction. It distinguishes between the following economic functions:

- Insurance coverage as a precondition for economic activity;
- Insurance coverage as a precondition for individuals to go about their daily lives;
- Insurance payments that are vital to individuals' financial security;
- Investment in and lending to the real economy;
- Acting as a counterparty in derivatives, repo, and securities lending markets; and
- Pooling of risk, particularly reinsurance, as an economic function.
- The continuity needs are different for each economic function of insurance.¹³ The implications for resolution and the assessment of criticality therefore differs depending

¹³ The type of insurance and the economic function it performs determine among other elements the continuity needs in resolution, that is whether there is a need for the insurer in resolution to maintain:

- the ability to continue to write new business;

on the function a specific type of insurance performs in a jurisdiction and the continuity needs attached to it. The Consultative Document describes in detail the ‘main considerations’ or ‘drivers of criticality’ that are relevant for the assessment of continuity needs and overall criticality of the different types of insurance and provides examples of functions that could be critical.

3.2. Main considerations applied in the case studies

The case studies show that all four jurisdictions have used main considerations or drivers of criticality which are described in the Consultative Document and identified critical functions of several types of insurance. The following summarises some examples presented in the case studies noting that the case studies themselves are not exhaustive and provide different levels of detail. For example, France shared the detailed results of its preliminary critical functions assessment while Australia has not yet completed its insurer-specific assessment and has not provided conclusive information about the identification of specific functions.

3.2.1. *Insurance coverage as a precondition for economic activity*

- Authorities have identified several critical functions in the frame of insurances whose coverage is a precondition for economic activity, notably agricultural insurance (France, China, Netherlands). In France, agricultural insurance is particularly sensitive in a context of climate change and rising losses, and the failure of a given insurer could lead to the failure of farms and by contagion to the agri-food sector, which could need State intervention that resolution aims to prevent.
- France also identified credit insurance as a critical function. While credit insurance coverage is not mandatory by law, it tends to be required in practice and is a precondition to economic exchanges between firms.
- In addition, France identified construction liability insurance as critical by nature, due to national specificities. Indeed, the coverage is mandatory and therefore, there is a high potential impact of breach of protection on the capacity for the various policyholders (builders, developers) to continue their activity, with a potential larger spill over effect on the construction industry and counterparties (customers, suppliers, creditors).
- Australia, France and the Netherlands have identified medical liability as potentially critical. As coverage is mandatory in these three jurisdictions, medical professionals need to be covered to be able to practice.

3.2.2. *Insurance coverage as a precondition for individuals to go about their daily lives*

- Critical functions have been identified when it comes to insurance coverage necessary for individuals to go about their daily lives, as not having this type of insurance would

• the continuity of existing insurance cover, for example, avoiding termination of cover before the term of the insurance policy has expired; or

• the continuity of payments falling due under cover written before the commencement of resolution.

FSB (2016), p.15.

prevent individuals from undertaking some activities. In this context, China and France have identified motor liability insurance as potentially critical. One can explain this convergence by the mandatory nature of those coverages in the three countries, meaning that people would be unable to use their vehicle without coverage.

3.2.3. *Insurance payments that are vital to individuals' financial security*

- Almost all authorities have identified as critical, insurances whose payments are vital to individuals' financial security. France, Netherlands and China have identified respectively as critical functions savings, pension products and universal insurance. This can be due to national savings or retirement structures and the landscape of insurers. In those countries, there exist very large life insurers with high market shares, leading to an increase of criticality of those functions. As for example in France, life insurance is one of the main saving products of individuals as it represents around 35% of total financial savings.

3.2.4. *Investment in and lending to the real economy*

- Criticality through the role of insurers as institutional investors and lenders to the real economy was identified in some Chinese insurers identification results. This may be related to the existence of insurance conglomerates in China (insurances holding banking entities).
- As for France, this role is taken on through life insurance volumes invested in the real economy, for example invested in government and corporate debt. The failure of a large life insurer may cause funding gaps that may not be met by other capital market participants. Moreover, it can cause contagion and instability in case of massive surrenders: it may force the insurer to dispose of large quantities of its assets very quickly to meet the withdrawals. This may then cause falls in market prices, that may lead to loss of confidence and lead to further disposal of assets by other firms.

3.2.5. *Acting as a counterparty in derivatives, repo and securities lending markets*

- Most authorities have not considered criticality through the prism of insurers acting as a counterparty in derivatives, repo, securities lending markets, or through reinsurance. Only in the Netherlands, interconnectedness of individual insurers with the financial system is taken into account when assessing potential impact of their failure on financial stability.

3.2.6. *Pooling of risk, particularly reinsurance, as an economic function*

- None of the four case studies reported this type of critical function.

Overall, it appears that the authorities in the four jurisdictions build their criticality assessment on the same main considerations, such as market concentration, market share, size of insurer,

type of policyholders and the mandatory nature of a given coverage.¹⁴ It can be noted that only France considers the complexity of products and looks at whether the market is profitable or not (an unprofitable market lowers the substitutability of a given function).¹⁵

For a function to be critical it is necessary that the sudden failure to provide that function would be likely to have a material impact on the financial system and the real economy. In some jurisdictions, authorities may consider it necessary to preserve continuity of functions that are material to the real economy. The case study on France shows that French authorities consider functions as critical if they are likely to have an impact on the real economy or on financial stability with a view to the fundamental importance of mandatory insurances' functions that solely concern real economy, but in such a way that their continuation was deemed necessary. For example, the disruption of major insurer on the motor vehicle insurance market would have a significant impact on the real economy regarding both private individuals and businesses, but the direct impact on the financial markets may be less obvious. The same applies to agricultural insurance: the failure of a given insurer would have a potential significant impact on the agricultural sector, and, through a spill over effect, on agri-food businesses. In this case, too, there direct link with the disruption of the financial markets may not be so obvious.

Other jurisdictions appear to pay attention to functions that are important to the real economy without specifying whether this could identify a critical function without additional material impact on the financial system. Australia evaluates the potential impact of the discontinuation of a function on both customers and the wider financial system. The Netherlands assesses whether the failure of an insurer could cause a great negative impact on society in the context of a public interest test.

3.3. Overview over critical functions and main considerations

The table below provides an overview over the functions that have been identified as critical, are considered to be potentially critical (possibly after further assessment) or have been taken into account when analysing the criticality of functions of insurers. Based on the examples provided by jurisdictions. The table also describes the main considerations and reasons taken into account for the assessment of functions and which lead to the conclusion to identify or not a function as critical.

Table 1: Overview over the main considerations for the assessment of Critical Functions applied in selected jurisdictions

Jurisdiction	Critical Function or resolution objective	Main considerations
Australia	Formal assessment not yet complete	• Formal assessment not yet complete

¹⁴ The four case studies do not include potential external financial support or public intervention (as for example the intervention of PPS – policyholders protection schemes, or resolution funds) in their substitutability analysis. These types of funds may be available in some jurisdictions to support the resolution of an insurer which provides critical functions and is earmarked for resolution. However, they are not taken into account for the assessment of the substitutability of a specific function for the purpose of determining its criticality.

¹⁵ Note that France provided considerably more detail regarding their considerations than the other three jurisdictions. It may therefore not be excluded that those other jurisdictions applied similar considerations as well.

Jurisdiction	Critical Function or resolution objective	Main considerations
China	A variety of insurance functions have been identified as critical	<ul style="list-style-type: none"> Given the vast business differences between insurers and the “bottom-up” identification approach, it is generally not possible to summarize all critical functions in one single list.
France	Savings, in euro and unit-linked	<ul style="list-style-type: none"> Massive volumes Presence of players with sizable market shares Existence of guaranteed yield contracts Spill over effects (for example reputational risk and massive withdrawals for all life insurers) Significant impact on the real economy or financial stability in case of inability to comply with commitments
	Motor vehicle including civil liability	<ul style="list-style-type: none"> Compulsory insurance Concentrated market Constraint related to a 40 days’ time limit to transfer contracts after withdrawal of authorisation to the insurance undertaking (article L. 326-12 of the French Insurance code) Significant impact on the real economy or financial stability in case of breach of protection or inability to comply with commitments
	Medical liability (professional insurance)	<ul style="list-style-type: none"> Compulsory insurance Niche market with very few players Constraint related to a 40 days’ time limit to transfer contracts after withdrawal of authorisation to the insurance undertaking (article L. 326-12 of the French Insurance code)
	Construction	<ul style="list-style-type: none"> Compulsory insurance Concentrated market Technically complex products Recent proven difficulty in recovering portfolio from failing insurers under FPS (Freedom to Provide Services) Medium impact on the real economy or financial stability in case of breach of protection or inability to comply with commitments
	Agricultural insurance	<ul style="list-style-type: none"> Niche and highly concentrated market Mostly uncompetitive and unprofitable market Tailor-made products Constraint related to a 40 days’ time limit to transfer contracts after withdrawal of authorisation to the

Jurisdiction	Critical Function or resolution objective	Main considerations
		insurance undertaking (article L. 326-12 of the French Insurance code) <ul style="list-style-type: none"> • Significant impact on the real economy or financial stability in case of breach of protection or inability to comply with commitments
	Credit insurance and bonding	<ul style="list-style-type: none"> • Market concentrated around three players • Technical knowledge of the market required • Significant impact on the real economy or financial stability in case of breach of protection or inability to comply with commitments
The Netherlands	To avoid great social consequences (and to protect policyholders)	<ul style="list-style-type: none"> • Size of insurer • Type of insurance product • Type of policyholders • Expected shortfall at failure
	To avoid significant impact on financial system or real economy (and to protect policyholders)	<ul style="list-style-type: none"> • Impact and substitutability on niche markets • Systemic relevance including interconnectedness with financial system • Impact on trust in financial sector and insurance sector

4. Assessment methodology

4.1. Critical functions and resolution planning

All four jurisdictions have enabling policy to facilitate the identification of critical functions.¹⁶ The critical function assessment is either performed as part of the resolution planning process for insurers subject to resolution planning requirements, or as part of a test which determines which insurers will be subject to resolution planning requirements.

China and France have conducted or required critical function assessments for all insurers subjected to recovery and resolution planning. Australia intends to conduct and require its firm specific critical function assessments to insurers subjected to resolution planning as part of its resolution planning process. The Netherlands conducts an annual public interest test for all authorised insurers to determine which insurers will be subject to resolution planning requirements. The public interest test includes the assessment of critical functions.¹⁷

¹⁶ APRA (2023), *Prudential Standard CPS 900 Resolution Planning*, May. CPS 900 comes into effect on 1 January 2024.

¹⁷ For the Netherlands, although the resolution regime does not explicitly aim at identifying critical functions, when conducting the public interest test against its resolution objectives, one could argue that significant impact of the failure of an insurer on society (objective B), financial system, or economy (objective C) implies that this insurer performs a critical function.

Insurers subjected to resolution planning vary across the four jurisdictions, summarised in the table below:

- In Australia, insurers that are designated as SFIs will be subjected to resolution planning (11 insurers). An SFI is defined as having assets greater than \$10bn for General Insurers (GIs) and Life Insurers (LIs), or greater than \$3bn for Private Health Insurers (PHIs) or is determined as such by APRA having regard to matters such as complexity in its operations or its membership of a group.
- In France, insurers with assets over EUR 50bn are subjected to recovery and resolution planning (14 insurers). The ACPR can also subject other insurers under this threshold to recovery and resolution planning based on other quantitative criteria and also qualitative criteria, and this has been applied to two insurance undertakings since 2022.
- In China, insurers with assets over RMB 200bn are subjected to recovery and resolution planning. The CBIRC and its local offices can also subject other insurers based on their assessment of an individual insurer’s business characteristics, risk profiles and spill over effects.
- In the Netherlands, the indicative thresholds for insurers to satisfy the public interest test are technical provisions greater than EUR 1bn or over 1 million policyholders, however judgement is made based on the assessment of a broader range indicators (between 10 and 15 insurers were eligible for resolution planning over the past three years).

Table 2: Scope of insurers subject to resolution planning requirements

Scope of insurers subject to resolution planning requirements	Australia	China	France	The Netherlands
Quantitative Thresholds	Assets greater than \$10bn AUD for GI and LI, \$3bn for PHI	Assets greater than 200 RMB	Assets greater than EUR 50bn	Technical provisions greater than EUR 1bn or over 1 million policyholders (indicative)
Qualitative judgement adjustment (for example due to group complexity or risk profile)	Yes	Yes	Yes	Yes

4.2. Three-step assessment methodology

All case studies apply the three-step methodology developed by the Consultative Document and the Resolution Planning Guidance pursuant to which a function is critical if it is identified by the impact and substitutability assessments (Steps 1 and 2) and passes the insurer specific test (Step 3), based on quantitative and qualitative considerations as described above in section 3.3. However, the sequence of these steps and the context in which the assessment is performed vary amongst the jurisdictions.

- Australia has conducted an interim system-wide impact assessment (Step 1) and substitutability assessment (Step 2) to identify potentially critical functions and will conduct firm specific tests (Step 3) on a case-by-case basis as part of the resolution planning process.
- France also conducted a system-wide impact and substitutability assessment, but then applied a criticality threshold of 10% market share to identify which insurers had critical functions (Steps 1 to 3).
- China's bottom-up approach requires insurers subjected to resolution planning to consider both impact and substitutability on an individual firm basis for critical functions assessments (Steps 1 to 3).
- The Netherlands assesses and forms a judgment on whether the failure of an authorised insurer could cause a great negative impact on society or a significant impact on the financial system or real economy, with consideration for substitutability for niche products, as part of a public interest test which determines which insurers are subject to resolution planning requirements (Steps 1 to 3).

5. Conclusions

The four jurisdictions which contributed their case studies to this paper have taken different approaches to the identification of critical functions. All appear to apply the three elements of assessment developed in the FSB Resolution Planning Guidance: the assessment of the impact on financial stability and real economy; the assessment of substitutability; and the insurer-specific assessment. However, the sequence of these steps and the context in which the assessment is performed vary amongst the jurisdictions.

Most critical functions have been identified in relation to insurance payments that are vital to individuals' financial security, where insurance coverage is a precondition for individuals to go about their daily lives and where insurance coverage is a precondition for economic activity. Authorities seem to take a broad view on the impact on the real economy, also taking into account the impact on communities and industries and the social function of insurers. Critical functions in relation to investment and lending to the real economy and acting as a counterparty in derivatives, repo and securities lending markets are limited to one case study or have been reported less.

The examples indicate that there is a large variety of functions which are or could be critical for the financial stability and the real economy, which corresponds to the large variety of products and functions of insurers. The main considerations shared in the four case studies draw upon considerations described in FSB guidance and preparatory work.

Abbreviations

ACPR	Autorité de contrôle prudentiel et de résolution
APRA	Australian Prudential Regulation Authority
Assessment Methodology	FSB's Key Attributes Assessment Methodology for the Insurance Sector, Methodology for Assessing the Implementation of the Key Attributes of Effective Resolution Regimes for Financial Institutions in the Insurance Sector
CBIRC	China Banking and Insurance Regulatory Commission
Consultative Document	FSB's consultative document on Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services
DNB	De Nederlandsche Bank
GI	General Insurer
KAs	FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions
LI	Life Insurer
PHI	Public Health Insurer
PPS	Policyholder Protection Schemes
Resolution Planning Guidance	FSB's guidance on Developing Effective Resolution Strategies and Plans for Systemically Important Insurers
SFI	Significant Financial Institution