September 2023

Insurance Recovery & Resolution Directive (IRRD) — key messages ahead of trilogues

Summary

There are very few cases of insurance failures, and while shareholders and other investors have lost money when these occur, there are even fewer cases where customers have lost money. This has been the case even before Solvency II but this regulation has further improved the consistency of supervision and insurance company risk management across the EU and increased customer protection even further. When asked by EIOPA about insolvencies during the period 1999–2021, national supervisors only identified 13 cases in which there were important gaps in their national toolkit for dealing with such insolvencies.

The Insurance Recovery & Resolution Directive (IRRD) should therefore be proportionate to the size of the issue it is aiming to solve.

The Solvency II prudential regime already addresses many of the concerns that the IRRD aims to resolve. It provides:

- A very high level of protection for policyholders and beneficiaries through extensive quantitative (Pillar I) and qualitative (Pillar II) risk management requirements complemented by very high levels of disclosure (Pillar III).
- A clear supervisory ladder of intervention based on two different quantitative capitalisation levels. The early warning solvency capital requirement (SCR) already triggers the requirement for the development of a recovery plan.
- Existing and new supervisory tools to monitor and maintain financial stability.

The final IRRD should reflect the following aspects of the insurance sector's unique business model, which limits the need to develop an extensive recovery and resolution framework:

- Insurance liabilities are long-term and prefunded. Therefore, insurance company failures happen over a period of time, ie, not overnight as in other financial sectors, allowing supervisors to take preventative action before insolvency actually happens.
- Systemic risk is significantly lower in insurance than in banking and other non-bank sectors.
- The critical functions provided by insurers are very limited in comparison to those of banks.

The European Parliament and the Council of the EU have introduced some positive amendments, however, the co-legislators should consider some additional improvements to the proposal to result in a more effective and pragmatic approach.

Insurance Europe therefore urges the co-legislators to ensure that the final text minimises the cost and resources involved, is tailored to the insurance industry's business model, recognises EU national market differences and is aligned with, but avoids going beyond, agreed international standards.

Key messages

1. Only a limited number of companies should be within the scope of recovery and resolution planning requirements, and they should be determined through a risk-based assessment
2. Do not introduce a requirement for national resolution funding arrangements
3. Ensure the scope of the IRRD reflects national features, current legislation and legal forms, such as mutual undertakings and conglomerates
4. Ensure the SCR remains the primary intervention point for supervisors

1 Only a limited number of companies should be within the scope of recovery and resolution planning requirements, and they should be determined through a risk-based assessment

Pre-emptive recovery and resolution planning requirements should be limited to companies for which there is a real need and a tangible benefit. This can be achieved by adopting risk-based criteria to define the scope and by disregarding minimum market thresholds or target number of companies per member state.

While the industry recognises the potential benefits of preparing well for unforeseen events, insurers already assess the impact of adverse events as part of their risk management requirements under Solvency II. Any planning required by the IRRD, above and beyond that of Solvency II, should be restricted to a limited number of specific undertakings, selected on the basis of the risks they pose.

Recommendation

The insurance industry supports a coherent scope for planning requirements based on:

- a set of risk-based criteria and a public interest assessment, both for group and solo undertakings;
- no subsidiary-level pre-emptive recovery planning requirements when a group recovery plan exists;
- recognition of third-country group recovery plans from jurisdictions that have sufficiently robust regimes; and,
- full exclusion of low-risk profile undertakings (LRPU) from any planning requirements.

The European Parliament and Council positions have introduced some improvements to the EC's proposal, including:

- the Council's amendments related to risk criteria applicable to groups, exclusion of LRPU and recognition of third countries' pre-emptive recovery plans; and,
- the European Parliament's revisions to limit any subsidiary-level planning requirements to those undertakings which have no group pre-emptive recovery plans in place.

However, the Parliament or Council proposals would result in too many companies in scope, creating additional and unjustified burdens for insurers, the costs of which will ultimately be borne by policyholders. The Council and EP proposals to introduce atificial minimum scope requirements should be removed. In addition, the EP position should consider cross-border as an important factor rather than a criterion per se.

2 Do not introduce a requirement for national resolution funding arrangements

The EC proposal does not introduce external funding arrangements. This decision is based on EIOPA's impact assessment, which found the inclusion of these arrangements disproportionate.

The limited financial stability risks arising from the failure of an insurance undertaking in Europe do not create the need for a harmonised approach to resolution funding. Given the existence of elements that significantly reduce the exposure of insurers to systemic risk, as outlined in the introductory section, the need for additional financing arrangements is very limited. Requirements specifying ex-ante funding would be especially onerous.

Recommendation

The industry supports the EC's proposal that there be no requirement for resolution funding arrangements. However, the positions of the Parliament and the Council both endorse the introduction of this type of funding arrangement. In this scenario, it is important to ensure:

- national flexibility (no requirements for ex-ante funding);
- limiting the "no creditor worse off" (NCWO) principle for compensation for policyholders; and,
- ensuring a single point of entry under which subsidiaries are exempt from national funding obligations if covered in a group resolution plan.

3 Ensure the scope of the IRRD reflects national features, current legislation and legal forms, such as mutual undertakings and conglomerates

The scope of the IRRD should allow for more national flexibility and consider the specific features of mutual and conglomerate undertakings.

In addition, specific national features should be reflected in the implementation of the directive in different markets.

Some national markets already guarantee the continuity of insurance relationships in the event of a failure of an undertaking (for instance, through insurance guarantee schemes (IGS) or current insolvency laws), meaning they already meet the Directive's objectives.

Recommendation

The industry supports the scope of an IRRD in which legal forms such as conglomerates and mutual undertakings are appropriately reflected.

While the Council proposes that member states can adapt resolution tools to mutual undertakings, the Parliament's position better reflects the features of conglomerates. Hence, the approach proposed by the Parliament for conglomerates and by the Council for mutual undertakings is supported by the industry as it makes it possible to reflect different legal forms.

4 Ensure the SCR remains the primary intervention point for supervisors

There should be seamless integration of any resolution powers into the existing Solvency II ladder of supervisory intervention.

In the IRRD, there should be clarity on the roles, responsibilities and powers of the supervisory authority and resolution authority during a period of deteriorating financial conditions.

This should be clarified in the Level 1 text to avoid, inter alia, conflicting supervisory actions. Resolution should also only occur if Solvency II's minimum capital requirement (MCR) is breached and not restored within three months as per Article 139 of Solvency II.

Recommendation

The industry supports the following:

- The SCR should continue to serve as the early intervention point. Intervention before the SCR is unnecessary, elevates overall capital requirements and could have an impact on companies' competitiveness.
- Only national supervisory authorities (and not resolution authorities) should be empowered to trigger resolution.
- The reduction of proposed powers for resolution authorities to address impediments to resolvability ("Alternative measures" (Art. 15)) to avoid undermining the SCR as the key intervention point.

Neither the Council's nor the Parliament's proposals address the industry concerns about the inclusion of powers for the resolution authority to intervene in fully solvent undertakings that are meeting all other Solvency II requirements.

5 Other issues

The industry also supports the following aspects of the recent Parliament and Council positions on the IRRD text.

- The Parliament's proposal that member states should refrain from the creation of separate entities (subject to national specificities).
- The Parliament's proposal to update pre-emptive and recovery planning to a biannual basis and to those undertakings at risk of further financial deterioration.
- The alignment of the Solvency II group supervisor text with the IRRD, replacing references to "ultimate parent undertakings" with "ultimate (re)insurance undertakings or insurance holding companies",
- The Parliament's proposal to allow portfolio transfer to existing national protection schemes.
- Ensuring that any resolution decision by a national resolution authority about an undertaking that is part of a group is coordinated and decided at college level to ensure consistent protection for policyholders across the group. Resolution decisions should not be based on a competition to make the first move.

Additional information can be found in Insurance Europe's "Key priorities on the EU Insurance Recovery & Resolution Directive (IRRD)", which includes the industry's views on the EC proposal.