OVERVIEW OF THE PROPOSAL FOR AN INSURANCE RECOVERY AND RESOLUTION DIRECTIVE

EIOPA Staff Paper

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1. INTRODUCTION

The disorderly failure of an insurer or a group of insurers may pose risks to financial stability and to policyholders. Insurance undertakings provide important services to other actors in the financial system, policyholders and companies. Studies document that the insurance sector contribution to overall systemic risk has been increasing.[1] Due to their interconnectedness, a failure of a large insurer or the simultaneous failure of several insurers, may have negative repercussions on other parts of the financial system. Equally, it is key to ensure that at the moment of failure the insurer continues to function as good as is possible in order to prevent policyholder detriment e.g. by continuing to pay out claims and pensions.

A regular insolvency procedure might be cumbersome and unable to manage a failure of an insurer in an orderly fashion. For example, the settlement of policyholders' claims could be considerably delayed possibly by several years, undermining the wider public's trust in the insurance sector as whole.

Therefore, an authority that is specialised in the insurance business, is familiar with the challenges of resolution, and is equipped with a set of specific tools, would be best placed to deal with situations of distress and default of insurers.

Finally, an important objective of a recovery and resolution regime is to prevent the use of public funds i.e. taxpayers' money. The ultimate goal is therefore to prevent failure - and if this is not possible - facilitate an orderly market exit.

The proposal put forward by the European Commission (COM) in September 2021, which will be briefly explained in the following paragraphs, is very much welcomed by EIOPA. This goes, in particular, with regard to the focus on the preventive approach, the fact that it addresses all relevant building blocks of a recovery and resolution framework, and the focus on cooperation and coordination among authorities. Although there are several technical issues that could be subject to debate (e.g. on how the tools will work in practice), EIOPA is generally in agreement with the proposal, which is fully aligned with the international standards. From that point of view, EIOPA believes that the approach and the main elements should broadly remain as they are.

[1] See ESRB 2017 Report, *Recovery and resolution for the EU insurance sector: a macroprudential perspective* for further details.

2. OVERVIEW OF THE MAIN ELEMENTS AND EXPECTED BENEFITS

- ***Comprehensive framework***. The IRRD, which largely corresponds to and expands on EIOPA's technical advice, is a comprehensive framework for the insurance sector, which covers all relevant elements, such as recovery and resolution planning, preventive measures, resolution aspects (objectives and tools) and cooperation and coordination. The framework proposed takes duly into account the insurance-specific features.

  Member States may introduce additional measures and powers at the national level, as long as these are compatible with the objectives and principles set out at the EU level. This gives Member States the flexibility to address any national specificities of their insurance market at the national level.

  EXAMPLE OF EXPECTED BENEFIT

  There will be one single/harmonised framework across the EU avoiding the current fragmentation in terms of objectives, tools and authorities involved. This is particularly beneficial with regards to undertakings or groups operating in several Member States.

- ***Preventive planning***. COM's proposal requires recovery plans to be drafted by an undertaking, and resolution plans to be drafted by authorities with regards to a wide range of insurance undertakings. Supervisors will have to identify the insurers that are obliged to draw up pre-emptive recovery plans based on a number of factors. 80% of a Member States' market should be covered. The plans will be assessed by the supervisory authorities. Some insurers will get simplified obligations. Resolution plans, in turn, are made by the Resolution Authority. 70% of a Member States' market should be covered. Resolvability assessments should also be included.

  EXAMPLE OF EXPECTED BENEFIT

  Preventive planning becomes a fundamental element. The underlying idea is that crisis prevention is less expensive and more effective than crisis management.

- ***Resolution authorities (RAs)***. The IRRD also proposes to appoint a new type of authorities, which should be equipped with a minimum harmonised set of powers. RAs are in charge of undertaking all the relevant preparatory and resolution actions. The proposal does not say who the authorities should be, but instead requires structural arrangements to be in place to avoid conflicts of interest between the supervisory and resolution functions.

EXAMPLE OF EXPECTED BENEFIT

RAs will be able to deal with distressed institutions without always recurring to the liquidator, which typically have very little experience in dealing with insurance undertakings. RAs both have specialised knowledge on the insurance undertaking itself, the insurance market, the possibilities for winding down insurers and the interconnectedness with other undertakings or other parts of the financial sector.

- ***Resolution objectives***. COM's proposal considers four important objectives that authorities should take into account, namely, the protection of policyholders; the maintenance of financial stability; the continuation of critical functions; and the protection of public funds. These objectives are not ranked in terms of relevance, and resolution authorities shall balance them as appropriate to the nature and circumstances of each case.

EXAMPLE OF EXPECTED BENEFIT

Whereas a liquidator typically has an optimal (financial) result for all creditors as the objective, the RA will look at the bigger picture for both policyholders and society as a whole. This does not mean creditors could be worse off financially, as the "no creditor worse off" principle is a safeguard.

- ***Conditions for resolution***. They are currently defined as follows:

1. The institution is failing or likely to fail;[2]
2. There is no reasonable prospect of any private sector measure to prevent failure within reasonable timeframe, and

[2] This requires that that the company is, either:
- In breach or likely to be in breach of the MCR without reasonable prospect of compliance being restored,
- It no longer fulfils the conditions for authorisation or fails seriously in its obligations,
- It is unable to pay its debts or other liabilities, or
- Extraordinary public financial support is required.

3. Resolution is necessary in the public interest. This is the case if resolution is necessary for and proportionate to the achievement of one or more of the resolution objectives mentioned earlier. Normal insolvency proceedings would not meet the objectives to the same extend.

EXAMPLE OF EXPECTED BENEFIT

Clear conditions for resolution in line with the international standards are proposed. Taking resolution actions should not be done too soon, if there is still a good chance that the undertaking will recover, but also not too late, so that the situation does not deteriorate further unnecessarily. The conditions defined aim to strike the right balance. Safeguards also apply. Three main issues to consider, i.e. an independent valuation; the no creditor worse off than in liquidation and the right of appeal.

- ***Resolution tools***. One of the fundamental elements of the proposed Directive are the set of resolution powers it includes. It goes from the more traditional ones, like the run-off or the portfolio transfer (where there is a lot of experience by authorities), to others that are newer.

Bail-in	• Write-down of liabilities or conversion to shares – policyholders cannot receive shares
Solvent run-off	• Withdrawal of authorisation and run-off
Sale of all or part of the business	• To third party / parties
Bridge undertaking	• Public controlled entity where assets and liability are temporarily managed
Asset and liability separation	• Impaired or problem assets and/or liabilities can be transferred to a management vehicle
Additional national tools and powers	• If consistent with framework

EXAMPLE OF EXPECTED BENEFIT

The broad range of tools provide authorities with flexibility. This is important, as the reasons for failure are not known beforehand, as are the market conditions in which the failures occur. The flexibility in the use of tools can help the RA to reach the optimal solution in any situation.

- ***Resolution colleges***. A last but definitely very relevant piece of the framework refers to cooperation and coordination. In this context, the role that resolution colleges will play should

be highlighted. Resolution colleges will need to be created under the leadership of the group resolution authority. The objective is to coordinate preparatory and resolution measures among national authorities. A relevant role has also been assigned to EIOPA in terms of promoting and monitoring the functioning of colleges and ensuring convergence across colleges.

EXAMPLE OF EXPECTED BENEFIT

Resolution colleges are supposed to address one of the key issues always highlighted in the different consultations, namely, the need for cooperation and coordination among authorities, which we know is key to ensure a successful resolution process, particularly in cross-border cases.

3. RATIONALE FOR THE IRRD

In EIOPA's view, there are three main arguments that explain the need for a harmonized recovery and resolution framework for (re)insurance like the IRRD:

1. The financial crisis of 2008 has shown the need to have proper recovery and resolution frameworks in place for different segments of the financial sector incl. (re)insurance to: a) Reduce the likelihood of insurance failures; b) Reduce the impact if they finally materialise; and c) Minimise reliance on taxpayers money.
2. Insurance failures and near misses are not rare.[3] Despite the fact that Solvency II has produced a positive impact, it is not a zero-failure regime.
3. The FSB Key Attributes[4] and the IAIS ICP 12[5] set out new core elements such as legal powers, funding arrangements, resolution tools and requirements for planning and cross-border cooperation to facilitate effective resolution of any financial institution that may be systemic importance. These elements are generally lacking in the different Member States. Indeed, several gaps were identified in different EU Member States in the analysis carried out by EIOPA, and some countries (FR, NL or RO) have already started enhancing their national frameworks.

The lack of harmonisation in recovery and resolution practices in the EU complicates cross-border cooperation and coordination in crises. Indeed, a patchwork of national rules could impede the orderly resolution of cross-border insurers, may lead to unequal treatment of policyholders, and is not in line with the spirit of the internal market.

[3] EIOPA's database of insurance failures and near misses contains 219 cases to date, which date from 1999 to 2020, of 31 EU countries. See https://www.eiopa.europa.eu/sites/default/files/publications/reports/eiopa-bos-21-394-failures-and-near-misses-database-report.pdf.

[4] The Key Attributes of Effective Resolution Regimes for Financial Institutions issued by the Financial Stability Board ('Key Attributes') are a core element of policy measures adopted by the G20 following the Great Financial Crisis; they address the problem of financial institutions considered "too big to fail. There are in total 12 Key Attributes; altogether they form the international standard for resolution regimes for any type of financial institution

[5] The International Association of Insurance Supervisors (IAIS) is an organisation of insurance supervisors and regulators from around the globe. It is the international standard-setting body responsible for developing and assisting in the implementation of supervisory and supporting material for insurance supervision. In this capacity, the IAIS issued so-called Insurance Core Principles (ICPs) as a globally accepted framework for insurance supervision. ICP 12 in particular id dedicated to Exit from the Market and Resolution and can be seen as a 'translation' of the FSB Key Attributes – which apply to any financial institution - into concrete standards for insurance supervision.

There are already recovery and resolution frameworks for the banking sector and for Central Counterparties, so the proposal for an IRRD, published by COM in September 2021, is a way to complete the picture and develop a framework for the insurance sector.[6]

THE IRRD AND THE BRRD COMPARED

It is sometimes argued that the IRRD is too much based on the Bank Recovery and Resolution Directive (BRRD). In EIOPA's view, there are indeed important similarities between both frameworks, but this is fully justified given that both frameworks are inspired by the same international standards and that, to a certain extent, the general process of a resolution does not need to differ considerably.

This does not however compromise the need to have insurance-specific framework. In fact, there is a need to ensure consistency across the financial sector, which will be particularly helpful in the case of conglomerates. A few examples of differences and similarities are outlined below.

Both with regard to the similarities and differences, there is a rationale behind. In summary, although the wording of both Directives may have similarities in several instances, the IRRD is an insurance-specific framework that takes into account the specific features of the insurance business.

Examples of relevant similarities	
Resolution objectives	Important similarities; there is, however, flexibility for authorities to decide which one take precedence, and this may lead to differences in the application of the resolution framework in banking and insurance (e.g. financial stability may be more relevant for banks).
Conditions for resolution	Overarching ideas are the same; however, the details of these conditions will be sector-specific.
Cooperation	Similarities concerning cross-border resolution, relations with third countries and establishment of the Resolution Committee.
Safeguards	Same safeguards concerning e.g. treatment of shareholders and creditors in the case of partial transfers and application of the write-down or

[6] In 2014, the legislators adopted the Bank Recovery and Resolution Directive (BRRD) in response to the banking failures and unprecedented level of public intervention which has materialised. After the BRRD, the focus turned to central counterparties, and the relevant regulation was adopted by the European Parliament and the Council in December 2020.

	conversion tool, valuation of difference in treatment and protection for financial collateral, set off and netting agreements.
Examples of relevant differences	
Capital buffer for banks	The BRRD foresees specific capital buffers such as minimum requirement for own funds and eligible liabilities (MREL) to be held for the purpose absorbing potential losses. An MREL would inflate the balance sheet of insurers and entail high costs for the industry that, at this stage, does not seem justified.
Resolution funding financed by the banking industry	The Single Resolution Fund (SRF) is financed by contributions from the EU banking industry. Its funds may be used – subject to strict rules - to complement other measures during resolution. No such EU-wide fund is foreseen for the insurance industry.
Resolution tools	The toolkit has been adapted to the need of the different sectors. For example, the IRRD includes the solvent run-off as one of the resolution tools.
Preventive powers	The BRRD gives more (intrusive) powers to intervene pre-emptively, as compared with the IRRD. This is in line with the rationale of the ladder of intervention that is already in Solvency II.

4. EIOPA'S ROLE

EIOPA will have new responsibilities in the area of recovery and resolution. The Authority has been assigned with two types of tasks, some more temporary and some more permanent tasks. The temporary ones consist in the development of an important number of guidelines, RTS and ITS. If the framework is adopted, EIOPA will work closely with the NCAs to develop the technical material.

The permanent tasks, in turn, are fundamental to make sure that the framework works well, particularly when it comes to cross-border cases. Indeed, EIOPA will have to establish a Committee in which all heads of the RAs are represented (the Resolution Committee), take part in the resolution colleges and, more generally, promote resolution convergence. The overall idea is that EIOPA is well placed to ensure consistency and enhance coordination.

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