IMPROVING FINANCIAL REGULATION

OPINION: RECOVERY & RESOLUTION

# EU IRRD law needs national discretion

Make the new EU recovery and resolution rules manageable!

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Just before Christmas a provisional political agreement was reached on the Insurance Recovery and Resolution Directive (IRRD). This was not an early Christmas gift for the insurance industry. The industry is sceptical about the need for such an extensive regime at EU level given existing regulation and safeguards, especially the EU's prudential framework for insurers, Solvency II.

According to the European Commission, the IRRD will increase policyholder protection, strengthen financial stability, and reduce the potential burden on taxpayers of failing insurers. It is expected to be applied in late 2026 and requires Member States to set up national insurance resolution authorities with powers to resolve failing insurers. Solvency II already allows supervisors to intervene early and requires insurers to prepare recovery plans once the Solvency Capital Requirement is breached, a point at which the insurer is still far from insolvency. However, the IRRD gives authorities preventive powers to intervene at an even earlier stage and requires many undertakings to draw up pre-emptive recovery plans before any indication of problems. In addition, resolution authorities will draw up resolution plans for numerous undertakings.

## Not evidence-based, the IRRD fails to meet its goals

Regrettably, the IRRD is not based on a comprehensive analysis of any gaps in current legislation and insolvency laws. This lack of evidence-based policymaking has resulted in a new regulatory framework to prevent and manage insurer failures that the insurance industry believes to be overly burdensome, too extensive, and disproportionate. We fail to see how the IRRD will increase policyholder protection and strengthen financial stability, at least in Sweden. On the contrary, it might lead to higher premiums, fewer insurance products and an overall reduction of insurance protection.

Failures of insurance undertakings have been rare in the EU even before the introduction of Solvency II. Given the general lack of interconnectedness among insurers, the risk that such failures would affect other insurance undertakings or the financial system is low. Thus, failing insurers pose limited, if any, financial stability risk. On the contrary, with good governance, responsible risk management and a long-term perspective, Swedish insurers have been a stabilising factor in turbulent times. At the same time, they have ensured that Swedish policyholders have access to good insurance policies.

In our opinion, the IRRD does not sufficiently consider differences between insurance markets within the EU, such as the size of the market and type of insurers on the market. According to the IRRD, a significant proportion of each national insurance market must comply with the new requirement to have pre-emptive recovery and resolution plans regardless of the risk of the individual insurers. For some markets, this planning requirement could, thus, also include small insurance companies, which would bring unnecessary operational burdens and additional costs.

The costs of the planning and other requirements are difficult to estimate as the policymakers have not provided a thorough analysis of the consequences of the IRRD. This includes that all Member States must have resolution financing arrangements paid by the insurers that under certain circumstances compensate shareholders, creditors, policyholders, and beneficiaries in the event of a resolution.

## More crucial regulatory work to come

The full consequences of the IRRD are still unknown because many technical issues remain to be decided. EIOPA will draft more than 15 technical standards and guidelines in the next phase of the development of the IRRD.

One example is the guidelines on simplified obligations for pre-emptive recovery and resolution planning aimed at making this requirement more proportionate. The simplified obligations will be decisive for the operational burden on small companies required to have such plans. To reduce this burden, there should be a large amount of national discretion in these guidelines. Member States must be given the leeway to choose the recovery and resolution features that best suit their markets.

Another example is the guidelines on identification of critical functions. Resolution authorities must draw up resolution plans for all undertakings that in their opinion perform a critical function. However, the definition of a critical function for insurance is still unclear. These guidelines should also be flexible to cater to national features, for example, the role of insurance in society and the financial markets. What is classified as a critical function in one Member State should not by default be classified as a critical function in other Member States. It should also be possible to conclude that there are no critical functions performed by insurers in a Member State.

It is worth noting that, according to current planning, these guidelines and other regulatory technical standards (RTS) may be issued after the application date. As they could be crucial to how the IRRD will be implemented, efficient preparation will be difficult. The application date should, therefore, be postponed.

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## Important national prerequisites differ

The required resolution authority may be either within the national supervisory authority or at a separate authority. Either way, it will need to hire new staff, especially if the designated authority lacks sufficient knowledge of insurance, to avoid treating insurers in the same way as banks. This is another cost arising from the IRRD that will ultimately impact customers.

Another important national decision concerns the required resolution financing arrangements, in particular, the question of whether funding by insurers should be through ex-ante or ex-post contributions or a combination of both. Ex-ante funding would lead to a resolution fund for insurance and consequently additional unwarranted costs for the industry.

Furthermore, the resolution tools in the IRRD assume external shareholders, which is not the case for Swedish mutual undertakings. An important national issue is, therefore, to adjust the resolution tools so they also apply to mutual undertakings.

## Policymakers can still improve the IRRD

A high level of policyholder protection is of utmost priority. However, Solvency II already ensures very high levels of protection and the Swedish insurance industry believes there are more efficient ways to strengthen consumer protection than to introduce an overly burdensome resolution framework.

The consequences of the IRRD will, to a large extent, depend on forthcoming technical rules. To make some of the problems of the IRRD more manageable, it is vital that policymakers, both at EU and national level, incorporate national discretion and proportionality into technical standards and guidelines and acknowledge domestic features in the national implementation.

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