Response to EC Better Regulation consultation on its proposal for the recovery and resolution of (re)insurance undertakings

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Introduction

The Insurance Europe Reinsurance Advisory Board (RAB) welcomes the opportunity to contribute to the European Commission’s consultation on the proposal for an Insurance Recovery and Resolution Directive (IRRD).

The Commission’s proposals in areas such as recovery and resolution allow for what the RAB strongly believes would be an unjustified and significant increase in regulatory requirements and operational and reporting burdens. In the RAB’s view, one of the key drivers of all these challenges is inappropriate recognition of the specific nature of reinsurance.

The RAB believes that, in the context of the IRRD the scope of recovery and resolution should be aligned, the resolution should take a top-down approach at group level, and that specific, simplified obligations should be considered for reinsurers given the characteristics of reinsurance business. In addition, there is no justification for the blanket inclusion of all reinsurance groups in the resolution regime.

Reinsurance activity contributes to the overall resilience of the insurance market by pooling and diversifying risks across lines of business and geographies. It is wholly dissimilar to banking business and there is a lack of evidence of any exposure to bank run-like liquidity stresses or an impact on systemic risk:

- The potential failure of a reinsurer is very unlikely and has no direct impact on policyholders. The premiums ceded are still accounted for in the technical provisions of the cedant insurers, which meet their obligations to the beneficiaries.
- Regarding activity-based systemic risk, reinsurance is primarily about property, casualty and biometric risks. Those risks are not linked to the financial cycle and therefore traditional reinsurance activities are not subject to “bank runs” or the risk of fire sales.
- Regarding behaviour-based systemic risk, reinsurance activity covers long-tail risks in particular. This feature, combined with the fact that reinsurers are balance-sheet light compared to other financial institutions and their activity is not correlated to the financial cycle, means that they are not prone to herd behaviour.
- The fact that the reinsurance market is dominated by global players should be seen positively. This allows risks to be pooled and then diversified on a global scale, thus mitigating the impact of external shocks. In addition, the reinsurance market is highly competitive and therefore reinsurance portfolios are easily transferable and entities easily substitutable.
Despite the importance of reinsurance in mitigating tail risks, the linkage between reinsurers and primary insurers should not be overstated. Indeed, just 5% of primary insurers’ written premiums are ceded globally to reinsurers.

The interconnections between reinsurers are also low. Retrocessions account for only 13% of global reinsurance premiums and 0.6% of global primary insurers’ written premiums. Moreover, the retroceded premiums are still accounted for in the technical provisions of the cedant reinsurers such that retrocessions have no similarity with off-balance sheet securitisations.

As a result, the specific characteristics of the reinsurance business should be recognised. In particular:

- The second sentence of Recital 1 should be entirely redrafted to reflect the above-mentioned points. Recital 1 should explain that an appropriate framework for reinsurers should consider the limited impact on policyholders, on the financial markets and the continuity of the real economy that would result from the distress or failure of one of them.

- The scope of proposed recovery and resolution plans should be significantly reviewed such that reinsurance groups would only be in scope on a case-by-case basis, decided by the group supervisor or the resolution authority supported by a risk-based assessment of the criteria of Article 9(2) and the existence of critical functions.

- Significant improvement of the proportionality of the recovery and resolution regime is necessary, in particular through the following measures:
  - For deciding whether a group is in scope, the size criterion needs to be objectivised. (Re)insurance groups should be presumed out of scope if they are below a certain threshold expressed in asset size, unless the supervisors or the resolution authorities decide to the contrary on the basis of the other criteria.
  - Reinsurance groups in scope after a decision by the group supervisor or the resolution authority should be granted the simplified obligations set out in Article 4 by default. Those simplified obligations should be further specified in the Directive and the EC’s Delegated Regulation.

- The recovery and resolution regime should follow a group approach, including for non-EU groups headquartered in equivalent jurisdictions or jurisdictions that provide similar safeguards in terms of the recovery and resolution of undertakings.

- The recovery and resolution regime should not encourage gold-plating at local level, as this contradicts the objective of the single market. Therefore, the Directive should not leave the door open to member state options or the possibility to go beyond the European regime.

Detailed comments

Correction of a typographic error on the target market shares for the application of the IRRD

Art.5(2) and 9(2) of the IRRD contain a typographic error in the description of the life and non-life markets. At country level, there is economically two markets: the insurance and reinsurance market for life risks and the

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1 “Resolution authorities shall draw up resolution plans for insurance and reinsurance undertakings to be selected on the basis of their size, business model, risk profile, interconnectedness, substitutability and the likely impact of the failure on policy holders. When selecting the insurance and reinsurance undertakings subject to resolution planning, the resolution authority shall in particular take into account the cross-border activity of the insurance or reinsurance undertaking and the existence of critical functions. A threshold for groups, for instance determined in terms of total assets, would bring real proportionality in the regime and avoid capturing groups whose failure would have no impact on policy holders and limited effect on the financial system.”
insurance and reinsurance market for non-life risks. The error would artificially create four markets (two for direct insurers and two separate markets for reinsurers).

It is understood that the reference to local market shares should be aligned with that of Solvency II which, in article 35(6), sets out that “The limitation to regular supervisory reporting shall be granted only to undertakings that do not represent more than 20% of a Member State’s life and non-life insurance and reinsurance market respectively, where the non-life market share is based on gross written premiums and the life market share is based on gross technical provisions.”

**Art.5(2) second subparagraph** should therefore read: “Supervisory authorities shall ensure that at least 80% of the Member State’s life and non-life [insert: insurance] and reinsurance market respectively, where the non-life market share is based on gross written premiums and the life market share is based on gross technical provisions, shall be subject to pre-emptive recovery planning requirements pursuant to this Article.” Replicate the same amendment in Art.9(2).

**Significant modification of the scope of the recovery and resolution regime to make it risk-based and proportionate to the objectives**

The current scope of the Directive is not risk-based and, as a result, way too broad:
- At group level and EU level, it includes all the EU groups and all their entities.
- At solo level and country level, it targets a minimum market share of 70% and 80% for the life market and the non-life market respectively, potentially including subsidiaries of a group (see above, the separation of reinsurance can only be a typographical error).

Neither of the above two rules are risk-based and both lack proportionality. Furthermore, such a scope is detrimental to the competitiveness of the EU market as it clearly goldplates international standards:
- The FSB Key Attributes only require resolution plans for globally and domestically systemically important insurers.
- The IAIS states in its “Application Paper on Resolution Powers and Planning” that in most jurisdictions the development of a resolution plan is only required for a subset of insurers and not for the majority, also in line with Insurance Core Principle (ICP) 12.3.

The RAB strongly suggests redesigning the scope to make it risk-based and proportionate by:
- **Significantly downsizing the scope** of the regime in line with the objective set out in Article 18 (not all groups have the potential to disrupt the financial markets and the real economy, and reinsurance groups in particular will not impact the policyholders) and international standards.
- **Revising Article 7 on group recovery plans and Article 10 on group resolution plans** so that the inclusion of a (re)insurance group in the scope is not automatic but based on a case-by-case decision by the group supervisor or the resolution authority on the basis of the criteria in Article 9(2) and the existence of critical functions.
- **Creating, to objectivise the size criterion and foster convergence, a threshold expressed in asset size** under which (re)insurance groups would be presumed not in scope (unless the supervisor or the resolution authority comes with a risk-based assessment justifying the inclusion on the basis of the other criteria). Such a threshold should not be lower than €50bn.
- **Removing or significantly decreasing the market share targets**, which are not risk-based, capture different firms in different countries depending on the composition and concentration of their respective markets, and add complexity in the determination of the scope (it applies at solo/country level, as opposed to the group/EU level considered in articles 7 and 10).

The RAB would therefore redraft Art.7(1) as follows:

“Member States shall ensure that ultimate parent undertakings [insert: that meet the criteria laid down in paragraph 2a] draw up and submit to the group supervisor a group pre-emptive recovery plan.”
2a. The group supervisor shall subject the ultimate parent undertakings to pre-emptive recovery planning requirements where the total assets of the group, as valued under directive 2009/138/EC, exceed EURXXbillion, no lower than EUR50bn. The group supervisors may decide to subject the ultimate parent undertakings of groups whose total assets do not exceed EURXXbillion, as valued under directive 2009/138/EC, to pre-emptive recovery planning requirements. Each individual decision shall be based on an assessment of the likely impact for the policyholders of a failure of that undertaking or group considering its size, business model, risk profile, interconnectedness, substitutability and, in particular, cross-border activity and the existence of critical functions.

Low risk profile groups shall not be subject to pre-emptive recovery planning requirements.] (…)

Replicate the wording in article 10.

Top-down recovery and resolution at group level

The purpose of a harmonised resolution regime at EU level is to avoid a piecemeal approach to failing (re)insurers with cross-border business member state by member state. For a recovery and resolution regime to work in the EU Single Market, it needs to cater for a top-down resolution approach at group level. The same applies for the recovery of a (re)insurer as it needs a comprehensive view of the impacts of local and group recovery options and a holistic approach which can only be achieved at group level. It should be up to colleges of supervisors and colleges of resolution to function well enough to ensure that local issues are treated together with the group issues.

Consequently, supervisors and resolution authorities should not be empowered to subject an undertaking that is part of a group to the IRRD locally where either:

- the (re)insurance group does not meet the conditions to be included in the IRRD; or,
- the (re)insurance group met the conditions and a group plan covering local risks exists.

This is particularly important for reinsurers, as geographical diversification at group level underpins the business model of reinsurance.

The RAB is of the view that a group recovery and resolution planning approach should also be considered for non-EU groups. It is worth noting that for resolution planning that has been taken into account, given the provisions under Articles 72-77 on recognition of third-country resolution proceedings and the possibility for the EU and/or member states to establish bilateral agreements.

Therefore, the RAB suggests the removal of the bottom-up entry in the resolution option through the deletion of Art.7(4) “Supervisory authorities may require subsidiary insurance or reinsurance undertakings or the entities referred to in Article 1(1), points (c) and (d), to draw up and submit pre-emptive recovery plans in the following situations:

(a) no group pre-emptive recovery plan exists;

(b) the supervisory authority concerned demonstrates that the concerned entity is not sufficiently considered by a group pre-emptive recovery plan in light of the significance of the entity in question in the Member State concerned and in light of the obligations that comparable undertakings in that Member State are subject to”.

Home supervision of cross-border activities

Article 6(3) of the IRRD provides the possibility for host supervisory authorities, where a company carries out significant cross-border activities, to ask the home supervisory authority to provide the group pre-emptive recovery plan and make recommendations. While the RAB understands that cross-border issues need to be dealt with and the cooperation between national supervisory authorities to be promoted and enhanced, that should
not take place under the IRRD, which is a completely different piece of legislation to the Solvency II Directive, where the topic is already being assessed. The RAB does not see why the topic is also being “transported” to the IRRD. The same can be said for the same requirement in the case of group recovery planning (Article 7(5) of the IRRD).

**No gold-plating**

The IRRD, like Solvency II, should not allow gold-plating, thereby avoiding supervisory divergence. The breadth and level of granularity of the IRRD is such that there is no justification for allowing member states to go beyond it. The principle of minimum harmonisation should be removed, together with any member state option.

As a result, the minimum harmonisation principle in Art. 1(2) should be deleted: “Member States may adopt or maintain rules that are stricter or additional to those laid down in this Directive and in the delegated and implementing acts adopted on the basis of this Directive, provided that those rules are of general application and do not conflict with this Directive and with the delegated and implementing acts adopted on its basis.”

In the same vein, the member state option in Art. 5(2) subparagraph 3 should be removed: “In the calculation of the market coverage level referred to in subparagraph 2, the subsidiary insurance or reinsurance undertakings of a group may[insert: shall] be taken into account where those subsidiary insurance or reinsurance undertakings are part of a group for which the ultimate parent undertaking is drawing up and maintaining a group pre-emptive recovery plan referred to in Article 7.”

**Application of the simplified obligations for reinsurers by default**

The limited impact of the distress or failure of a reinsurer on policyholders, the financial markets and the continuity of the real economy should be recognised in the regime through more proportionality.

The RAB suggests achieving real proportionality in this regard by granting the simplification obligations to reinsurance groups by default (unless the supervisor or the resolution authority comes with a risk-based assessment justifying the full application of the regime). Beyond reinsurance groups, the same proportionality measure could be granted by default to insurance undertakings and groups below the asset threshold defined above for inclusion in the scope.

The RAB would therefore suggest the following:

Art.4 “[insert a new paragraph: 2a. Supervisory and resolution authorities shall apply simplified obligations to reinsurance groups as well as insurance and reinsurance undertakings and groups subject to pre-emptive recovery planning and resolution requirements and whose total assets are lower than [EURXXbillion, but not lower than EUR 50 billion]. In exceptional circumstances, the supervisory and resolution authorities may decide not to apply simplified obligations for an undertaking or group where applying simplified obligations would increase the risks for the policyholders of a disorderly failure of that undertaking or group considering its size, business model, risk profile, interconnectedness, substitutability and, in particular, cross-border activity.”]
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