Position Paper

Insurance Europe key messages on proposed Directive to establish a framework for the recovery and resolution of credit institutions

Our reference:	ECO-INV-12-088	Date:	16 November 2012
Referring to:	SWD (2012) 166		
Related documents:			
Contact person:	Damian McCullagh, Policy Advisor Macro-Economics & Life Insurance	E-mail:	mccullagh@insuranceeurope.eu
Pages:	3	Transparency Register ID no.:	33213703459-54

Summary

European insurance companies have approximately €7500 billion of assets under management of which, approximately 55%[1] is invested in both fixed income and loan assets. An insurer's investment strategy is generally driven by the need for both predictable and stable long term cash flows to meet insurance liabilities. In this regard, insurers are an important source of long term funding for the banking sector and the impact of the proposed Recovery and Resolution Directive on this funding process requires consideration.

Insurers recognise the importance of breaking the link between banks and their sovereigns. However, from an investor perspective, it is important that the proposed bank resolution tools strike a balance between ensuring an appropriate framework for managing resolution and recovery actions and maintaining sufficient incentives to invest in the banking sector. Specifically, the establishment of a bail-in regime could have a significant impact on investment decisions and, as a consequence, have implications for the banking sector's ability to successfully fund itself. An improperly calibrated bail-in mechanism could not only lead to an increase in the cost of banks' debt funding but could also restrict banks' access to long-term financing.

Insurance Europe strongly believes that the use of the proposed 'bail-in' mechanism by resolution authorities should be incorporated into a 'ladder of intervention' for use in the case of a failing credit institution. Within this framework, use of the bail-in mechanism should be limited to instances where a credit institution is no longer viable as a going concern. The assessment of whether a credit institution is failing should be based on clearly defined objective and quantifiable criteria and the process of making this assessment should be as transparent as possible. Supervisory discretion should be kept to a minimum to avoid disruptions in markets. In the interests of transparency, the bail-in mechanism should only be applied to debt issued following the entry into force of the Directive, with no impact on existing contracts.

Insurance Europe would suggest that in cases of bank recovery, creditor participations should be determined on a contractual basis within a minimum regulatory framework and should be distinct from the proposed bail-

[1] http://www.insuranceeurope.eu/uploads/Modules/Publications/european-insurance-in-figures2010.pdf

Insurance Europe aisbl
rue Montoyer 51, B-1000 Brussels
Tel: +32 2 547 5811 • Fax: +32 2 547 5819
www.insuranceeurope.eu

in mechanism (eg contingent convertible bonds). This would allow investors and banks to structure contractual parameters in advance in a manner acceptable to both and would avoid the need to implement prescriptive regulation. In cases of a bank recovery, this process would have the advantage of ensuring that the existing hierarchy of creditors is unaffected and the contract would be directly applicable to foreign creditors.

In the section below, there follow some specific comments on the proposed bail-in mechanism and on the scope and application of the directive.

Bail-in proposals

- The bail-in mechanism should be seen as a resolution and not a recovery tool. The proposed Directive allows supervisors a substantial degree of discretion in determining when to exercise the trigger for bail-in instruments. Such discretion might enable a quick and smooth resolution of a bank but also creates a risk that authorities will exercise the trigger before the point of non-viability has been reached. To retain sufficient incentives to invest in these instruments, Insurance Europe suggests that the directive make explicit that the exercise of the bail-in mechanism is limited to instances where it is clearly evident to supervisors that a credit institution is beyond recovery. In this regard the use of the bail-in tool should be limited to instances of "last resort", with supervisory authorities exhausting all other recovery tools prior to triggering the bail-in mechanism. (Article 37)

- Insurance Europe understands the rationale for excluding claims with maturities of less than one month, as set out in Article 38, on the basis that a limited degree of liquidity support for the bank might actually help to avoid the bail-in scenario. However, it should be noted that the exclusion of such instruments solely on the basis of maturity compromises the principle of pari passu and disadvantages long-term investors in the case of an insolvency. Careful analysis is needed on the extent to which this exception could incentivise very short-term bank funding, potentially accelerating the financial difficulties of a bank in distress. (Article 38)

- The Directive states that the bail-in tool will only be applied after 1 January 2018. Greater certainty is needed as to whether current long-term contracts with a maturity date beyond 2018 are to be considered eligible liabilities in any possible future application of the bail-in tool. Insurance Europe believes that a bail-in mechanism should apply only to debt issued following the entry into force of the directive. In this regard, there should be no impact on existing contracts. (Article 38)

- The proposed Directive leaves the decision to exclude covered bonds from the scope of the bail-in mechanism partially to the discretion of member states. Insurance Europe strongly believes that secured debt such as asset-backed securities and covered bonds should have clearly articulated protection in a bail-in regime. The cover pool for such instruments should only serve as collateral for the relevant creditors. (Article 38)

- The proposed Article 43 distorts the hierarchy of capital structure somewhat, and may have the effect of restricting the scope of future bank financing programmes. Insurance Europe believes that all creditors and equity holders should be treated in accordance with their position within the capital structure. (Article 43)

- Insurance Europe believes it is important to clarify who would be liable if, following judicial proceedings, it was found that resolution authorities had erred in enforcing the bail-in clause. A clear indication of who would be legally responsible to make restitution to investors as a result of an inappropriate use of the bail-in tool following judicial proceedings is necessary within the Directive. (Articles 90-99)

Scope of the directive

- The proposal mentions that resolution authorities could take a resolution action in relation to an institution or a parent undertaking under certain conditions. Insurance Europe believes it to be important to adequately recognise the relationships of the subsidiary under resolution and the respective parent company under company law. Parent companies that do not fully own a subsidiary should not be forced to bear 100 per cent of losses following a resolution action by a regulatory authority.

- Clarification is needed regarding the possible consequences of the proposal for insurance entities within a financial conglomerate that also includes credit institutions and investment firms. Non-financial holding companies have been included under article 1 (c) and (d). Article 28.2 and Article 28.4 suggest that those holding companies could also be subject to resolution. The use of resolution tools could affect the stability of insurance companies within a group, and the status of policy holders in this situation is unclear. (Article 28)