Svensk Försäkring

13/01/2022

Insurance Sweden's response on the Better Regulation Consultation on EC's proposal of IRRD

Insurance Sweden welcome the opportunity to comment on the proposed Insurance Recovery and Resolution Directive (IRRD). As a member of Insurance Europe, we share the views expressed in their response on the European Commission's (EC) proposal of IRRD. In this response we wish to highlight and elaborate a bit further on some of the issues with IRRD from a Swedish perspective and express our strong objection of introducing EC's proposal of IRRD. This is a too burdensome, extensive, and disproportionate framework for recovery and resolution of (re)insurance companies in Sweden and the rest of EU, with no benefits for the financial stability in Sweden or for Swedish policyholders. In our response we also want to express our strong objection of having requirement of market coverage for recovery and resolution planning.

No need of IRRD from a Swedish perspective

In our view, the rationale behind any recovery and resolution framework is the need to prevent and handle a situation where a disorderly failure of an institution would have an impact on financial stability, and where the prudential rules have been deemed insufficient to deal with the situation. A recovery and resolution framework should therefore be seen as a "regulation of last resort". However, our view is that there is no need at least for Sweden for a "regulation of last resort".

Swedish and other EU insurance companies played no part in the global financial crises 2008 – 2009 and the European insurance sector have exhibited resilience during the COVID-19 pandemic crisis. This can also be seen in EIOPA's recent stress test that indicates that the sector even under a severe scenario proves to be able to meet its' promises to the policyholders. According to EIOPA's insurance statics, Swedish insurers have an average MCR-ratio of above 900 per cent and thereby much higher than the required 100 per cent. This also shows the strength and resilience also for those Swedish insurance companies not included in EIOPA's stress test.

Furthermore, insurance failures are very rare and given the general lack of interconnectedness do not affect other insurers, the payment systems or other parts of the financial system. Thereby, in contrast to banks there are very limited, if any, financial stability risks of failing insurers. It is rather the opposite since the insurance companies have supported the financial system and the society during e.g. the global financial crises and during the COVID-19 pandemic. With stable governance, responsibility and long-term perspective, Swedish insurance companies have been a stabilizing factor during these turbulent periods. At the same time, the companies have ensured that Swedish policyholders have access to good insurance policies.

Should an insurer fail, there is no evidence of a lack of substitutability of products that would justify the introduction of the proposed IRRD in Sweden. Furthermore, no Swedish taxpayer money has been used to restore the deteriorated financial position of Swedish undertakings, which is one the main reason behind IRRD (see e.g. recital (2)). In addition, just a few, if any, insurers provide critical functions for which there could be a need to ensure a rapid transfer and continuation, one of the resolution objectives in IRRD.

If a crisis does occur, insurers as opposed to banks can typically be wound up in an orderly manner through run off and/or portfolio transfers. It is therefore problematic that IRRD in large parts is merely a copy of BRRD where the fundamental differences between banks and insurance companies have not been considered, for example in respect of systemic risks they impose and the risks for the financial stability in the event of failure of an institution. This will lead to unnecessary cost and operational burden for the insurance companies, without any benefits in Sweden for the financial stability or for the society as a whole.

There are more efficient ways to improve policyholder protection than IRRD

One of the stated reasons for the IRRD by EC is the need to increase policyholder protection within EU. However, policyholder protection is the very purpose of prudential regulation and the current level of protection offered by Solvency II and national insolvency law already provides sufficient safeguards for Swedish policyholders (prudential rules, rules on winding-up and right of priority). The introduction of Solvency II as well as other new legislations such as IDD have significantly improved policyholder protection. The 2018 review of Solvency II, e.g. through new LAC DT requirements, have introduced even stricter regulatory requirements. That will also probably be the outcome of the 2020 review, IRRD excluded, with for example the introduction of macroprudential tools for insurance.

Good internal governance and control, appropriate capital requirements and effective supervision are much more important to good policyholder protection than harmonization of recovery and resolution within EU. In fact, if these elements are in place, we think that such a framework are not necessary. Thus, enhanced and efficient supervision (including in cross-border cases) would be the most efficient way to improve policyholder protection and not IRRD.

Thus, rather than implementing IRRD, existing tools and powers should be fully used and resources adequately assigned towards a proper enforcement of Solvency II. We also believe that the proposed IRRD will have negative implications for the Swedish insurance market and, thereby, Swedish policyholders. If decisions about introducing IRRD are not preceded by an extensive and thorough impact assessment and seen in relation to other parts of Solvency II and the 2020 review, there is a very large risk that the proposed IRRD will only result in large (unnecessary) costs and other negative consequences without any substantial improvements. In our view, any decision on IRRD should be postponed until the amendments in the current review of the Solvency II Directive and the delegated regulation have been finalized.

EC also states problems with policyholder protection when insurance companies operate cross-border as a motive for IRRD (see e.g. recital (6)). Rather than implementing IRRD existing supervisory measures could be used to examine characteristics of cross-border business that give rise to excessive risks. In addition, there are efficient solutions how to tackle those problems at a much earlier stage, for example by strengthen the Colleges of Supervisors. Main risk factors indicating future problems of cross-border business usually include fast growth, considerably low prices, unusual terms and a narrow range of products.

IRRD may lead to weakened insurance protection for Swedish households and companies

The costs of IRRD, especially the costs for more administration for pre-emptive recovery and resolution plans, will in the end lead to higher premiums for important insurance products. Higher premiums could make financially vulnerable households less inclined to buy insurance policies. In this sense, the proposed IRRD could reduce the overall level of insurance protection in the society, which in the end could imply higher costs for the government.

The requirement of resolvability in IRRD may also make insurers less willing to offer certain insurance products because it will be unclear how the resolution authority will treat these products in their assessment of resolvability. Thus, this could have a negative impact for those companies and other policyholders that demand/need those insurance products.

It is noteworthy that policyholders are almost forgotten in IRRD although the aim according to EC is to increase policyholders' protection. For example, the resolution tools in article 26 – 39 focus only on the share- and debtholders. However, a resolution of insurance companies may involve a write-down of insurance claims, as mentioned in article 34. But how such a write-down should be conducted is not mentioned in IRRD, besides very general wording in some recitals (e.g. 30 and 47). We believe that if this is not explicitly regulated, then there is a risk that IRRD will result in weakened policyholder protection in the case of resolution and failure of an insurance company.

IRRD neglects a large part of the insurance market, i.e. mutual insurance companies

Many Swedish and other EU insurers are mutual insurance undertakings and have no external owners. Thus, for mutuals there are no shareholders that can bear first losses, only policyholders. This is also true for other legal forms of undertakings without shareholders. That imply, for example, that actions under resolution that require sale of shares or converting debt to equity are not possible to apply on a mutual insurance company.

The requirements and especially the resolution tools in IRRD are not suitable for mutual insurance undertakings. One of the resolution objectives is to protect policy holders, beneficiaries and claimants. We strongly question how policyholders in a mutual insurance undertaking can be protected in a resolution. Furthermore, when resolution authorities assess the resolvability of mutual insurance undertakings,

they have to respect the characteristics of the legal form of the company and should not be able to demand any kind of demutualisation.

Large degree of flexibility for the Member States is needed

There are important differences between Member States regarding, e.g., the social welfare system, the current winding-up process for insurers, type of insurance companies (mutuals etc.), insurance products lines and the extent to which insurance companies provide critical functions. Member States should, therefore, be allowed flexibility to choose the recovery and resolution features that best suit their market.

IRRD gives national authorities far-reaching, intrusive, and arbitrary powers, especially the alternative measures in article 15. These measures include that the undertaking must divest specific assets or restructure liabilities, restrict or prevent the development of new or existing business lines as well as the sale of new or existing products. Another example is requirements to change legal or operational structures of the undertaking, which could imply large costs and other negative consequences. The resolution authority can require these measures also in situations where the undertaking have a very strong financial position and there is no risk of economic failure. It could therefore be questioned if IRRD is proportional and how it will benefit e.g. policyholders.

We think that only with sufficient Member State flexibility can IRRD be proportionate. Just because recovery and resolution frameworks have been introduced for the banking and CCP sectors it does not mean that such framework is proportionate for the insurance sector.

There should be no requirement for market coverage for recovery and resolution planning

One example on the need to have a national flexibility is the proposed scope of the requirement of pre-emptive recovery and resolution plans. We strongly oppose having a requirement of market coverage for pre-emptive recovery and resolution plans (article 5 and 9). The problem with such coverage requirement can be seen when ranking Swedish life and non-life insurance companies based on their size (technical provisions and gross written premiums, respectively). Then at least 27 Swedish insurance companies would have to draw up pre-emptive recovery plans (with a market coverage of 80 per cent) and for at least 19 companies the Swedish resolution authority would have to draw up resolutions plans (with a market coverage of 70 per cent) – see also the annex.[1]

Some of these non-life companies are small, with gross written premiums around 1 billion SEK (≈ 0,1 billion €) during 2020. In addition, several of them are local mutuals. Given the costs and operational burden for the insurers of pre-emptive recovery and resolution plans it is not proportionate to have such scope for these requirements.

[1] This includes a few companies that are part of a foreign insurance group or company.

Instead, any requirement of pre-emptive recovery plans shall only apply for those undertakings and insurance groups that provide critical functions and be based on the risk profile, complexity including cross-border activity, level of interconnectedness, substitutability, and potential impact on financial stability of a failure of the undertaking or group. The relevant national supervisory authority should make assessments of the need for pre-emptive recovery plans based only on a joint consideration of these criteria. A pre-emptive resolution plan shall only be considered if there is a risk that an undertaking or group might not fulfill the MCR requirement, i.e. there is risk that the MCR-ratio will be below 100 per cent in the near future.

If sufficient national flexibility is not introduced for the scope of companies obliged to draw up pre-emptive plans, at least it should be a very large national flexibility in how to implement simplified obligations in article 4 in IRRD. However, we don't consider this as an alternative that can make the requirements fully proportionate, mainly due to large uncertainty how the simplified obligations will be applied by Member States.

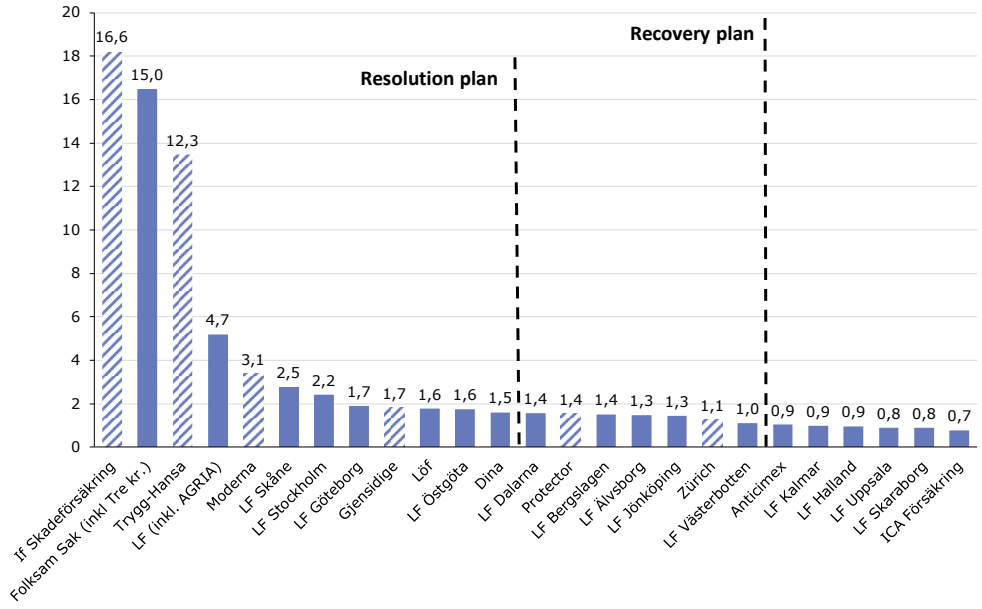
Other issues: Treatment of group companies need clarification

We agree that a group perspective should be applied in IRRD. However, it is not clear in the proposed directive if and how to apply resolution tools and powers to other group companies, that are not insurance companies or holding companies, whether regulated or not. The same goes for the resolution authorities' resolvability assessments and resolution planning.

Annex

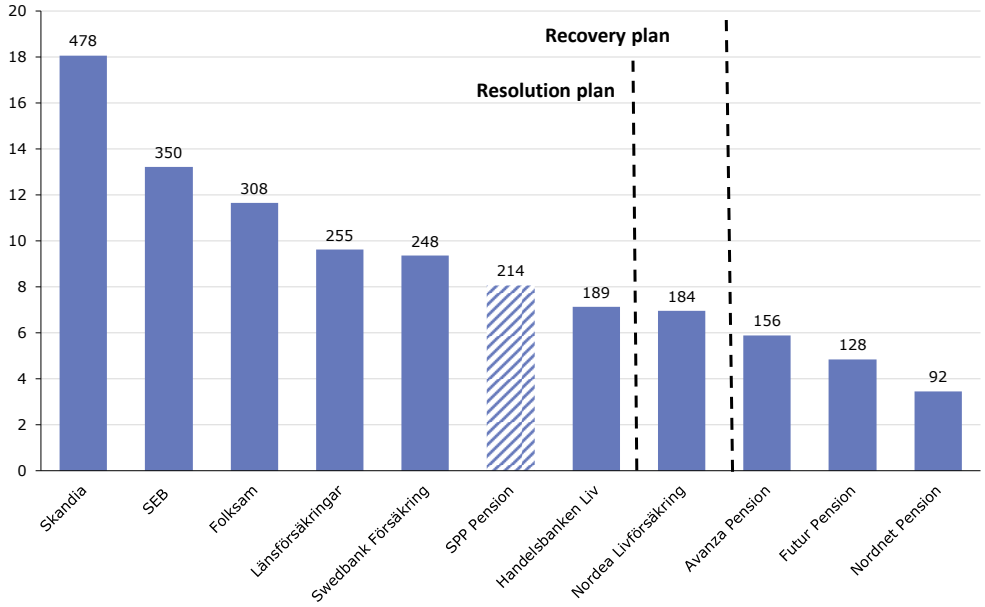
Swedish non-life insurance companies' share of total gross written premiums in Sweden 2020

Per cent (on top of the bar is gross written premiums during 2020 in bn SEK)



Swedish life insurance companies' share of total technical provisions in Sweden 2020

Per cent (on top of the bar is technical provisions in bn SEK)



Note: Dashed bar refers to insurance companies that are part of a foreign insurance group or company. The companies to the left of the line for recovery (resolution) plan represent 80 % (70 %) of the market.
Source: Insurance Sweden.