

Insurance recovery and resolution directive

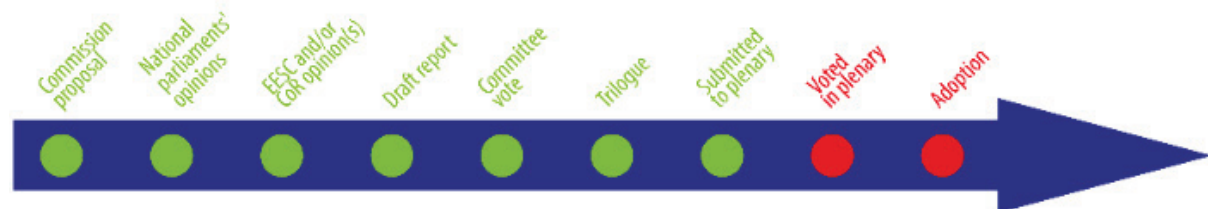
OVERVIEW

In 2020, the Commission launched a review of the Solvency II Directive, the EU's legal prudential regulatory framework for (re-)insurance companies, which entered into force in 2016. As one output of the review, the Commission made a proposal in September 2021 for a new directive establishing a framework for recovery and resolution of insurance companies – the 'IRRD proposal'.

The IRRD proposal would establish harmonised recovery and resolution tools and procedures, with enhanced cross-border cooperation between national authorities. The proposal adopts the 'pre-emptive' approach whereby insurance companies must submit plans to the supervisory authorities, which would be given powers to implement resolutions. The proposal also sets out a range of tools for resolutions.

In the European Parliament, the Committee on Economic and Monetary Affairs (ECON), in charge of the file, adopted its report in July 2023. Following trilogue negotiations, the co-legislators reached an inter-institutional provisional agreement on 14 December 2023, which the ECON committee approved on 29 January 2024. The next steps include the adoption of the text by the Parliament's plenary and by the Council. Once adopted, it will be signed by the Council and the Parliament and published in the Official Journal.

Proposal for a directive establishing a framework for the recovery and resolution of insurance and reinsurance undertakings		
<i>Committee responsible:</i>	Economic and Monetary Affairs (ECON)	COM(2021) 582
<i>Rapporteur:</i>	Markus Ferber (EPP, Germany)	22.9.2021
<i>Shadow rapporteurs:</i>	Aurore Lalucq (S&D, France), Stéphanie Yon-Courtin (Renew, France), Henrike Hahn (Greens/EFA, Germany), Marco Zanni (ID, Italy), Johan van Overtveldt (ECR, Belgium), Chris MacManus (The Left, Ireland).	2021/0296(COD)
<i>Next steps expected:</i>	Vote in plenary	Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')



Introduction

The prudential regulatory framework for the insurance industry in the European Union (EU) is governed by the Directive of 25 November 2009 on the taking-up and pursuit of the business of insurance and reinsurance¹ (**Solvency II**, [Directive 2009/138/EC](#)), which entered into force on 1 January 2016.

Solvency II is [built](#) on three pillars:

- Pillar I sets out the quantitative requirements for insurance companies, comprising the valuation of assets and liabilities and capital requirements;
- Pillar II sets out the qualitative requirements, comprising the governance and risk management of the insurance company and the own risk and solvency assessment ([ORSA](#));
- Pillar III sets the standards for supervisory reporting and public disclosure.

In 2020, the Commission initiated a [review](#) of Solvency II and on 22 September 2021, it tabled two proposals resulting from the review. One of these is the a proposal for a directive establishing a framework for the recovery and resolution² of insurance and reinsurance undertakings ([COM\(2021\)0582](#)) – also known as the 'insurance recovery and resolution directive' (**IRR**D).³ The IRRD proposal has been designed to harmonise EU Member States' laws on recovery and resolution of insurance companies – or introduce such a framework in some Member States – in order to enhance the level playing field in the EU. The legal basis for the proposal is [Article 114](#) of the Treaty on the Functioning of the EU (**TFEU**), which allows the adoption of measures for the approximation of provisions laid down by law in EU Member States, and which have as their object the establishment and functioning of the internal market ([Article 26 TFEU](#)).

Existing situation

Insurance companies and financial risks

While insurance policies typically protect against risks, such as damage to cars or homes, they can also provide services involving the accumulation of savings, which insurers channel into the 'real economy' by purchasing and holding bonds, for instance. Therefore, in the same way as for bank depositors, it matters for the beneficiaries, and for the continuity of insurance services, that there is a guarantee that insurers' potential failures will be resolved in an orderly manner. Furthermore, the failure of large insurance companies or a general failure of the industry could trigger threats to the stability of the entire financial system ('systemic risk'). Although Solvency II harmonised the 'prudential rules' on risk-related capital requirements and thus reduced the likelihood of failures and improved the resilience of the EU insurance industry, the possibility of insurance companies experiencing financial distress cannot be ruled out completely.

The framework for the recovery and resolution of insurance companies is currently governed by national laws. This has resulted in significant discrepancies across EU Member States in terms of substantive and procedural laws. Corporate insolvency procedures may apply in some instances, but this can be irrelevant to many insurance companies, since the procedures do not ensure continuation of their critical functions – a core objective of financial institutions' resolution frameworks.

International framework

At international level, in October 2014 the Financial Stability Board ([FSB](#)) developed [key attributes](#) of effective resolution regimes for the insurance sector, targeting any insurer that could be systemically significant or critical if it failed.⁴ The FSB released complementary guidance on developing effective resolution strategies and plans in June 2016, and on its key attributes assessment methodology, in August 2020. In parallel, in November 2019, the International

Association of Insurance Supervisors (IAIS) updated the [insurance core principles](#) for all insurance and reinsurance undertakings, previously adopted in 2014. The Common Framework for Internationally Active Insurance Groups (ComFrame) builds on the insurance core principles and details [standards](#) for pre-emptive recovery planning – i.e. before any financial distress occurs – and for internationally active insurance groups. It also details powers that authorities are expected to have available to manage an orderly exit from the market. Resolution planning was considered essential for individual insurance groups.

Preparation of the proposal

For the preparation of the proposal, the Commission [relied](#) on the preparatory work of the European Insurance and Occupational Pension Authority (EIOPA) and in particular its July 2017 [opinion](#), as well as its December 2020 [opinion](#) on the review of the Solvency II Directive.

In the first opinion – of July 2017 – EIOPA [argues](#) that there is a need to harmonise national recovery and resolution frameworks for insurers in the EU, taking into account Solvency II. The harmonised recovery and resolution framework should include a requirement for insurers to develop and maintain recovery plans in a 'pre-emptive' manner. This differs from Solvency II, whereby insurers are required to develop a recovery plan within 2 months of observation of non-compliance with the capital requirements. Instead, pre-emptive recovery plans are set out before any breach of the solvency capital requirement is observed.

The second EIOPA [opinion](#) – of December 2020 – reiterates a preference for the 'minimum harmonisation' approach, which entails the definition of a common approach to the fundamental elements of recovery and resolution, while leaving room for EU Member States to adopt additional measures at national level, subject to these measures being compatible with the principles, minimum requirements and objectives set at EU level. EU Member States should have in place an officially designated administrative resolution authority or authorities for the resolution of insurance groups, where mandates are clearly defined, roles and responsibilities are allocated, and there is a high degree of coordination.

In addition, the Commission published a [impact assessment](#) (SWD(2021) 260) to accompany the proposal. It includes a summary of the consultation, which raised several [issues](#) about the resolution of distressed insurance companies. Firstly, policyholders – i.e. beneficiaries of insurance policies – highlight that they are not consistently protected across the EU, in particular in the context of a cross-border failure. EU Member States' resolution regimes are often incomplete and uncoordinated. Secondly, insurance guarantee schemes have been developed by a majority of EU Member States for certain life or non-life policies, the approaches adopted diverge substantially, resulting in a 'patchwork' of national insurance guarantee schemes. As a result, some policyholders may be left without any protection. Public authorities therefore are insufficiently equipped to monitor, avoid and handle failures of insurers in an orderly fashion. Finally, the lack of harmonisation across the national recovery and resolution regimes and insurance guarantee schemes has a negative impact on the integration of the EU financial market.

EPRS has published an [initial appraisal](#) of the Commission's impact assessment.

The changes the proposal would bring

The IRRD would [create](#) a framework for a pre-emptive recovery planning and resolution regime in relation to all (re-)insurers established in the EU that are subject to Solvency II. The proposal takes a group-level approach to resolutions so as to address the failure of an entity affiliated to a group and avoid affecting the solvency and the operations of the rest of the group. This is especially relevant in a cross-border context. Moreover, in line with the proportionality principle, not all entities will be subject to planning requirements. The IRRD would establish criteria that will be assessed by supervisory and resolution authorities. The authorities would also be able to apply simplified obligations for recovery and resolution planning. However, to ensure an adequate degree of

preparedness across the EU, (re-)insurers that account for at least 80 % of an EU Member State's market should be subject to pre-emptive recovery planning requirements and for at least 70 % of an EU Member State's market should be subject to resolution planning requirements. Low-risk undertakings are exempt from these planning requirements.

The proposal envisages a strong coordination role for EIOPA, which will aim to reinforce convergence in the field of prevention and resolution. EIOPA is also mandated to work out agreements with third-country authorities that would serve as a template for bilateral agreements for national authorities in the area of insurance resolution.

EU authorities and advisory committees

EIOPA published an [overview](#) of the IRRD proposal and welcomed it, finding that: i) the IRRD proposal's approach focuses on prevention; ii) the IRRD would address 'all relevant building blocks of a recovery and resolution framework'; and iii) the IRRD proposal focuses on cooperation and coordination among authorities.

Although there are several technical issues that could be subject to debate (for instance on how the tools will work in practice), EIOPA considered the IRRD proposal to be aligned with international standards, and considered that the approach and the main elements of the proposal should remain broadly as they are.

In EIOPA's view, three main arguments explained the need for the IRRD.

- The financial crisis of 2008 showed the need to put recovery and resolution frameworks in place for different segments of the financial sector in order to reduce i) the likelihood of insurance failures; ii) the impact if such failures did materialise; and iii) reliance on taxpayers' money.
- Insurance failures and near misses are not rare.⁵
- Despite the fact that Solvency II had a positive impact, it is not a zero-failure regime. The FSB key attributes and the IAIS ICP 125 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 might be of 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 and 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 whenever crises occur. Indeed, national rules could undermine the orderly resolution of cross-border insurance companies in difficulty, and lead to unequal treatment of policyholders. This is against the spirit of the internal market.

Finally, EIOPA argues that the IRRD has a number of similarities with the Bank Resolution and Recovery Directive ([BRRD, Directive 2014/0059](#)) as they are both inspired by the same international standards and, to a certain extent, 'the general process of a resolution does not need to differ considerably'. Moreover, both the BRRD and the IRRD proposal leave sufficient room for sector-specific features (see box).

In its [opinion](#) of 23 February 2022, the European Economic and Social Committee ([EESC](#)) agreed that the crises recently experienced within the EU, such as the sovereign debt crisis, the low interest rate policy and the COVID-19 pandemic, have proved that the regulatory framework based on Solvency II should be adapted. The EESC therefore 'strongly welcomes' the Commission proposal to address systemic risks in the insurance sector.

The EESC also emphasises that the risk profile of insurers is changing. For instance, in light of the climate crisis, the insurance sector plays a particularly important role when it comes to insurance against the impact of climate change and new environmental risks, and insurers are also facing

higher risks in their role as investors. More specifically, the risks arising from climate change are not properly assessed. The EESC stresses the considerable interest of civil society in ensuring the stability of the financial sector and calls for sound capital requirements and risk preparedness in the insurance sector. The opinion concludes that instability in the insurance sector would significantly set back efforts to tackle the climate crisis and overcome the pandemic.

Box – The proposed IRRD compared with the BRRD according to EIOPA

	IRRD compared with BRRD
Resolution objectives	<u>Very similar</u> , but the flexibility introduced in by the IRRD proposal would allow the authorities to decide on the precedence of objectives, and may lead to differences in the application of the framework
Conditions for resolution	<u>Same approach</u> , but the details of the conditions will be sector-specific
Cooperation	<u>Very similar</u> : cross-border resolution, relations with third countries, establishment of the Resolution Committee
Safeguards	<u>Same treatment</u> of shareholders and creditors in the case of partial transfers and application of the write-down or conversion tool, valuation of difference in treatment and protection for financial collateral, set-off and netting agreements
Capital buffer for banks	<u>Unlike the BRRD</u> , the IRRD does not envisage minimum requirements for own funds or eligible liabilities to absorb potential losses. These would inflate the balance sheet of insurers and entail high costs for the industry.
Resolution funding financed by the banking industry	<u>Unlike the BRRD</u> , the IRRD does not envisage an EU-wide single resolution fund financed by banks.
Resolution tools	<u>The IRRD is adapted to the need of the insurance sector</u> . For example, the IRRD resolution tools include the solvent run-off, whereby an insurer is no longer authorised to conclude new insurance contracts.
Preventive powers	<u>The IRRD gives fewer (intrusive) powers</u> to intervene pre-emptively, as compared with the BRRD.

Source: Based on EIOPA [Overview of the proposal for an insurance recovery and resolution directive](#).

National parliaments

The deadline for the submission of [reasoned opinions](#) on the grounds of subsidiarity was 4 February 2022. No subsidiarity concerns were raised.

Stakeholder and academic views

[Insurance Europe](#), the European insurance and reinsurance federation, [declared](#) that the IRRD proposal goes beyond what is necessary, given the extensive protection for policyholders already in place. The federation took the view that the EU should avoid overburdening insurers with 'unnecessary and costly requirements' since, considering the specific nature of insurance activities and, provided that Solvency II was already in force, there was no need for such an extensive IRRD. Moreover, being to a large extent inspired by the BRRD, the IRRD was ignoring the specific characteristics of the insurance industry. For example, insurers do not 'regularly have to be resolved literally overnight' because, on the one hand, they receive a steady income from premiums which

ensures continuity and, on the other hand, insurance policy obligations are due over a longer time period. In addition, unlike banks, failing insurance companies generate limited financial stability risks. Finally, the federation [considered](#) the powers given to EIOPA and national authorities 'intrusive and arbitrary'. Similar positions are taken by other national insurance associations, such as [Nordic Insurers](#), which opposes the IRRD proposal, claiming that it would have no effect on either financial stability, or the protection of policyholders. In addition, it agreed that the BRRD framework is unsuitable for the insurance sector, while Solvency II already addresses the resolution of distressed insurance companies.

[Finance Watch](#), a consumer association, [welcomed](#) the IRRD proposal, as recovery and resolution frameworks in EU Member States are essential. However, the equivalent rules for the banking sector had proved extremely difficult to implement and enforce, if not impossible in some instances. In addition, the association was disappointed that no harmonised insurance guarantee scheme rules had been introduced, which would have ensured the protection of policyholders – insisting that every EU Member State should have an insurance guarantee scheme. Finally, it supported the high profile role given to EIOPA in cross-border disputes, as well as the requirement for supervisory authorities to cooperate.

[Consumer groups](#) such as [Better Finance](#) have nevertheless raised concerns regarding the possibility for the supervisory authority to 'convert to equity or reduce the principal amount of claims, including insurance claims' as a last resort. A Finance Watch representative added that there should be a 'calibration of the amount of losses shareholders and creditors should take, such that the likelihood that policyholders are touched is very low'.

Legislative process

European Parliament

On 25 October 2021, Parliament's Committee on Economic and Monetary Affairs (ECON) appointed [Markus Ferber](#) (EPP, Germany) as rapporteur for the file. The rapporteur tabled a [draft report](#)⁶ on 2 June 2022, and [amendments](#) to it were published on 18 July 2022. On 18 July 2023, the ECON committee adopted its [report](#) by 44 votes in favour, 7 against and 8 abstentions. ECON also voted for the opening of interinstitutional negotiations based on the adopted report. This decision was confirmed by Parliament during the September 2023 plenary session.

The report [proposes](#) to modify the scope of the proposal in such a way as to reinforce the role of the EIOPA. In addition, the resolution plans submitted by insurers would have to contain a preliminary assessment of the 'feasibility and credibility' of the winding-up under normal insolvency proceedings or of resolution actions. **Resolution authorities** should design resolution plans for each insurer subject to pre-emptive recovery planning requirements provided they assess that the public interest would be positive in the event of a failure or for which a critical function exists – considering size, business model, risk profile, interconnectedness, substitutability and cross-border activity. The report also suggests that Member States should ensure that **group resolution authorities** draw up group resolution plans to be activated in case the ultimate parent undertaking or one of the material undertakings within the group risks experiencing a significant deterioration of its financial position.

Financing arrangements should be established in each Member State to compensate policy holders, and such financing arrangements could be used to finance other costs associated with the use of resolution tools as a last resort. Member States should be given some flexibility in relation to the precise arrangements of external financing as long as the availability of sufficient liquidity to guarantee compensation within a reasonable timeframe is ensured. A Member State should impose a contribution obligation only on insurance and reinsurance undertakings authorised in that Member State and on branches of a third-country undertaking based in the EU.

Finally, as regards **insurance guarantee schemes**, the report suggests that their introduction 'be advanced', and that the possibility of introducing harmonised minimum basic requirements in the EU be assessed. The Commission would make such an assessment after sufficient experience in the application of the IRRD has been gained and after it has consulted with EIOPA, and it would report to the Parliament and the Council.

Council

The Council agreed on a [negotiating mandate](#) on 20 December 2022. It welcomes the introduction of a 'harmonised minimum European framework for the recovery and resolution of insurance undertakings, provided that this framework is proportionate, adapted to the insurance sector and contributes adequately to the protection of policyholders and the maintenance of financial stability in the EU's single market'. The Council emphasises the importance of establishing 'common rules and at the same time leave sufficient flexibility to national authorities to accommodate the specificities of their insurance markets and address the characteristics of the individual case'. The Council also declares that national authorities need to have sufficient powers to efficiently deal with insurance failures, even though safeguards need to be put in place to ensure fair treatment of all stakeholders.

Provisional agreement

On 14 December 2023, Council and Parliament reached a [provisional agreement](#), by force of which they established a new harmonised resolution regime at EU level. According to the text, the Member States will have to set up national authorities, vested with preventive powers to intervene. Moreover, Member States will have to ensure effective border cooperation among these authorities and grant the EIOPA a coordinating role.

Furthermore, (re)insurance companies, representing at least 60 % of the respective (re)insurance market, will have to draw up and submit pre-emptive recovery plans to national supervisory authorities. Furthermore, resolution authorities will have to draw up a resolution plan for insurance and reinsurance undertakings and groups, representing at least 40 % of their respective market. Small and non-complex undertakings will in principle not be subject to pre-emptive recovery planning requirements on an individual basis. The provisional agreement also provides resolution authorities with resolution tools and procedures to address failures, notably in a cross-border context. The use of the tools and procedures is subject to conditions.

Next steps

Parliament's ECON committee [approved](#) the provisional agreement by on 29 January 2024 by a large majority (30 to 4). The next steps include a plenary vote on the text (currently scheduled for the second April 2024 plenary session) and adoption by the Council. Once adopted, it will be signed by the co-legislators and published in the Official Journal.

EUROPEAN PARLIAMENT SUPPORTING ANALYSIS

Girard V., [Solvency II review](#), Initial appraisal of a European Commission impact assessment, EPRS, European Parliament, April 2022.

OTHER SOURCES

European Parliament, [Framework for the recovery and resolution of insurance and reinsurance undertakings](#), 2021/0296(COD), Legislative observatory (OEIL).

European Commission, [Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of insurance and reinsurance undertakings and amending Directives 2002/47/EC, 2004/25/EC, 2009/138/EC, \(EU\) 2017/1132 and Regulations \(EU\) No 1094/2010 and \(EU\) No 648/2012](#), COM(2021) 582, 22 September 2021.

ENDNOTES

- ¹ Solvency II [Article 13\(7\)](#) defines reinsurance as the activity consisting of 'accepting risks ceded by an insurance undertaking or third-country insurance undertaking, or by another reinsurance undertaking or third-country reinsurance undertaking'.
- ² The European Insurance and Occupational Pensions Authority (EIOPA) [differentiates](#) between recovery and resolution measures as follows. Recovery planning and early intervention refers to measures that reduce the likelihood of an insurer failing. Resolution refers to measures that reduce the costs and impact of an insurance failure – if this cannot be avoided.
- ³ The second proposal is a [proposal for a directive amending Directive 2009/138/EC \(Solvency II\) as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, group and cross-border supervision](#), COM(2021) 581.
- ⁴ The Financial Stability Board is an [international body](#) that monitors and makes recommendations regarding the global financial system. It coordinates national financial authorities and international standard-setting bodies to develop strong regulatory, supervisory and other financial sector policies. When the FSB adopted the [key attributes](#) in 2011, it was then agreed that it would develop further guidance on their implementation.
- ⁵ EIOPA defines a '[near miss](#)' a case as one where an insurer faces financial difficulties (for example, the solvency requirements are breached or likely to be breached) and the supervisor intervenes or places the insurer under some form of special measures.
- ⁶ The rapporteur's draft report suggested amending the proposal by removing any reference to minimal market coverage of insurance companies subject to pre-emptive recovery and resolution planning. It is argued that these thresholds seem 'arbitrary' and may be excessively high. The coverage should rather rely on a risk-based approach, in order to avoid the generation of unnecessary red tape.

In addition, the draft report regrets that the IRRD proposal is to a large extent inspired by the BRRD and does not give sufficient consideration to the specific nature of the insurance industry. Moreover, in order to avoid undue complexity, it suggests removing the requirement to create new national authorities.

Finally, the draft report removes the option to convert insurance claims into equity, or cancel or reduce them in the event of resolution, on grounds that such a decision relates to contractual rights, and should therefore remain with the competent courts rather than the recovery and resolution supervisory authorities. Finally, chapters are inserted that would require the Commission to take action to establish an insurance guarantee scheme.

DISCLAIMER AND COPYRIGHT

This document is prepared for, and addressed to, the Members and staff of the European Parliament as background material to assist them in their parliamentary work. The content of the document is the sole responsibility of its author(s) and any opinions expressed herein should not be taken to represent an official position of the Parliament.

Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy.

© European Union, 2024.

eprs@ep.europa.eu (contact)

www.eprs.ep.parl.union.eu (intranet)

www.europarl.europa.eu/thinktank (internet)

<http://epthinktank.eu> (blog)

Third edition. The 'EU Legislation in Progress' briefings are updated at key stages throughout the legislative procedure.