



# Recovery and resolution and macro-prudential implications

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# Advance warning

- Academic literature on R&R is dealing primarily with banks, but: what is good for banks is not necessarily good for insurance
- Research on insurance (failure) often looks at the US because of data availability, but the US is not the EU
- Insurance failures in the EU are (fortunately) not numerous
- Lessons learnt from insurance failures under Solvency I cannot be simply extrapolated to a Solvency II world
- Solvency II is still young and we have little experience about its impact on insurance failure
- Macro-prudential policy is still in the making
- Conclusion: we must be modest in our arguments

# Insurance failures

- The failure of an insurer is likely to have negative effects for stakeholders, including policyholders, employees, customers and creditors
- It has been said (GA) that, throughout history, the failure of an insurer has never caused a systemic financial crisis, as opposed to banking failures
- It is indeed unlikely that an insurance failure leads to “a disruption to the flow of financial services that is (i) caused by an impairment of all or parts of the financial system, and (ii) has the potential to have serious negative consequences for the real economy” (systemic risk definition)

# Insurance failures have happened

- A study of 3 US and 8 Japanese life insurance insolvencies in the past 2-3 decades shows that the regulatory regimes, without specific recovery and resolution measures, were able to mitigate the impact on policyholders and to sustain the financial stability of the markets
- In the EU, public intervention took place during the financial crisis, in the case of Ethias, KBC, Aegon, ING and SNS Reaal in order to restore market confidence
- The EIOPA data base also shows that there have been a number of failures and near misses in the EEA

# Objectives of insurance regulation

- Protection of policyholders and beneficiaries and financial stability
- The debate about R&R clearly shows that there can be conflicts between both objectives
- From a macro-prudential perspective, it may be desirable to apply resolution tools which negatively affect the rights of existing policyholders or beneficiaries in the interest of financial stability
- Which objective should come first and should an R&R framework also serve other objectives as proposed by EIOPA?

# Policyholder protection

- It is possible to develop a regulatory regime that protects policyholders for 100%, but: that might be the end of the insurance industry
- Supervision is still carried out as if the confidence level of the solvency regime were 100%
- We must learn to accept that insurers can fail and must be clear about the limits of the regulatory regime
- In an ideal world we would have Solvency II, combined with IGS and with R&R, designed at the same time
- If we now introduce IGS and R&R, we need to ensure that the regulatory regime is coherent

# Macro-prudential policy

- It is still unclear whether and to what extent insurance is systemically relevant (ABA v EBA)
- Although we do not know exactly what insurance is, it is clear that not all insurers are systemically relevant
- It is presumed that insurers might become systemically relevant, for instance if many life insurers would fail at the same time or if substitutability no longer exists
- The IAIS has a special regime for G-SIIs which are subject to an enhanced R&R framework used as a tool to address the “too-big-to-fail” issue

# Why do we have this debate?

- Insurance regulation in the EU and in MS is dealing primarily with living entities (and this should remain so)
- Solvency II deals a lot with prevention of failure
- Solvency II does not specifically deal with the consequences of a failure, beyond the ultimate supervisory action in the case of a breach of the MCR
- Two exceptions from the past: reorganisation measures and winding up (Title IV FD) but minimum harmonization
- Adopting a more coherent approach to insurance failures is in the interest of policyholders and financial stability



# Early intervention under Solvency II

- Existing early intervention mechanisms
  - Supervisory Review Process with early warning indicators
  - Supervisors have many possibilities to intervene if they believe that an insurer is experiencing difficulties
  - ORSA and stress testing as part of risk management
  - Supervisory ladder of intervention in the case of a breach of the SCR
  - Recovery plan in the case of a breach of the SCR and possibility to extend the recovery period

# Recovery planning

- From a macro-prudential perspective it is difficult to argue that all insurers should be required to draw up a pre-emptive recovery plan
- Proportionality is difficult to apply in practice as there always is a tendency to overshoot. Preference should be given to clear uniform criteria
- Pre-emptive recovery plans may be useful in the case of GSIs, insurance groups and very large insurers
- A recovery plan should be specific to each insurer, i.e. the approach should not be too formalistic

# Resolution planning

- From a macro-prudential perspective it is difficult to argue that resolution authorities should draw up pre-emptive resolution plans for all insurers
- The scope of application must take account of the possible impact of a failure for policyholders and for financial stability
- Here again, proportionality may not be a good solution and it is probably better to set clear rules
- The resolution authority should ex-ante assess whether winding-up does not provide a better solution

# Resolution

- EIOPA suggests the following conditions for entry into resolution:
  - The insurer is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so;
  - Possible recovery measures have been exhausted or cannot be implemented in a timely manner
  - A resolution action is necessary in the public interest
- I would replace the last condition by the necessity in view of the protection of policyholders and financial stability

# Resolution powers

- The introduction at EU level of a common set of resolution powers with consistent design, implementation and enforcement features seems to be in the interest of policyholders and of financial stability:
  - Some of the powers do not yet exist in MS
  - Some of the powers require a legal basis
  - Proportionality should be applied in such a manner that the implementation of the powers must take account of the size, nature and complexity of the insurer to be resolved and of the interest of all parties concerned

# Concluding remarks

- Insurance failures with cross-border implications and failures within the context of a financial conglomerate warrant special attention
- Minimum harmonisation seems attractive but experience shows that it is often a recipe for trouble
- Bail-in for insurers might have macro-prudential consequences because of the cross-sectoral implications
- Prevention and recovery should come first taking into account what already exists under Solvency II
- Expanding the resolution powers is in the interest of policyholders and financial stability