WILLIAM FRY

Submission to the Department of Finance

Public Consultation on the Development of a National Resolution Framework for (re)Insurers

This submission is made on behalf of William Fry LLP, a professional advisory firm and one of Ireland's leading law firms.

William Fry LLP welcomes the opportunity to comment on the Public Consultation on the Development of a National Resolution Framework for (re)Insurers (**Consultation Paper**). We would also welcome the opportunity to engage directly on the Consultation Paper; any correspondence in this regard should be addressed to any or all of:

- John Larkin, Partner, Insurance and Reinsurance, at john.larkin@williamfry.com;
- Ian Murray, Partner, Insurance and Reinsurance, at ian.murray@williamfry.com;
- Ruairi Rynn, Partner, Corporate Restructuring and Insolvency, at ruairi.rynn@williamfry.com, and
- Mike Frazer, Consultant, Insurance and Reinsurance, at mike.frazer@williamfry.com.

In this submission, we begin by highlighting the key considerations for a resolution framework for insurers and reinsurers that we believe are the most important (including areas that we believe have not been fully addressed in the Consultation Paper). We then go on to address each of the nineteen specific questions posed in the Consultation Paper.

Key Considerations

1. We note that, shortly after the publication of the Consultation Paper, the EU Commission published its "*Proposal for a Directive establishing a framework for the recovery and resolution of insurance and reinsurance undertakings*" - 2021/0296 (COD) (**Proposed Directive**). In this context, it is vitally important that a resolution framework implemented in Ireland be consistent with those applicable in other EEA member states so that neither Irish (re)insurance undertakings nor their policyholders are placed at a disadvantage relative to their competitors and their policyholders. Accordingly, it is welcome that the Consultation Paper states (on page 9) that " … *it is desirable, to the greatest extent possible, to align the approach with … any forthcoming proposals from the EU Commission*." It is unquestionably preferable that any domestic resolution framework would be consistent with, and implemented at the same time as, the EEA-wide approach.

2. With particular reference to Section 4 of the Consultation Paper, the current regime covering liquidations and examinerships of (re)insurance companies is principally governed by rules of company law[1] which are supplemented by a patchwork of domestic and European legislation[2] including, in the case of (re)insurance companies, the Insurance (No. 2) Act 1983 and, in the case of insurance companies only, the Insurance Act 1936 and Part 18 of S.I. No. 485/2015 - European Union (Insurance and Reinsurance) Regulations 2015 (**Solvency II Regulations**) (that transposed Directive 2009/138/EC (**Solvency II Directive**) into Irish law).

   Therefore, having regard for initiatives such as:

   - the proposals in the Consultation Paper;
   - the Proposed Directive, and
   - S.I. No. 184/2021 - Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Recovery Plan Requirements for Insurers) Regulations 2021 (**Recovery**

[1] Noting that these processes are available to most types of companies, not just (re)insurance companies.
[2] Noting that in addition to the various pieces of Irish legislation that may be relevant, new Regulation 2015/848 on insolvency proceedings will be relevant in the event of the liquidation of a reinsurance company.

Planning Regulations) that the Central Bank of Ireland (**Central Bank**) has recently introduced,

it would be extremely important that any further statutory amendments are undertaken in a comprehensive, consolidated fashion bringing together (to the extent practicable) all relevant existing legislation insofar as it will apply to (re)insurers. Further piecemeal amendments would create additional confusion for stakeholders.

It would also be important to ensure that any proposed amendments do not undermine the principles established by regulation 277(1) of the Solvency II Regulations, namely that insurance claims shall, with respect to assets representing the technical provisions of an insurance company, take absolute precedence over other claims of the insurance company including preferential claims (but subject to limited and identified priorities set out in the Solvency II regime).

In this regard, we note references in the Consultation Paper to a view that the interests of policyholders may rank on equal footing or *pari passu* with other creditors as opposed to preferentially to those other creditors in an administration or an examinership. Having regard for Regulation 277 (and Article 275) of the Solvency II Regulations and the priority afforded to policyholders in a winding-up with regard to assets representing the technical provisions, which would be respected in an administration or an examinership, we would not subscribe to that view.

We note certain enhancements that are being considered to the current insolvency framework for (re)insurance undertakings, namely:

- increasing the accountability of the administrator;
- facilitating the establishment of a liquidation committee; and
- expanding the grounds to petition for liquidation.

In principle, we would not be opposed to the suggested approach. However, we believe that if the Central Bank is to be given expanded powers to petition for liquidation of an insurer (and indeed to be given explicit powers to petition for the winding up of a reinsurer), those additional powers should not, other than in the case of fraud, gross mismanagement or established insolvency, be capable of being exercised by the Central Bank unless and until the various processes already provided for in the Solvency II regime have been carried out (e.g. the processes envisaged by Part 10 of the Solvency II Regulations (*applicable to undertakings in difficulty or in an irregular situation*)).

These processes are important to (re)insurers and their policyholders/cedants as they provide a window in which the (re)insurer (often with the support of its shareholders) can bring itself into compliance with its Solvency Capital Requirements (**SCR**) or its Minimum Capital Requirements (**MCR**), as appropriate. It should only be in the most extreme circumstances (such as fraud, gross mismanagement or established insolvency) that the Central Bank should be able to bypass these processes.

3. There is very limited specific reference to the reinsurance sector in the Consultation Paper, and we believe that explicit consideration of the different nature of reinsurers to insurers should be made. In this regard, we are assuming that, in the absence of any clear statement to the contrary, references to "insurers" in the Consultation Paper are intended to encompass "reinsurers" equally. As reinsurance undertakings don't have direct policyholders, the failure of a reinsurer does not present an immediate risk of policyholder detriment (albeit reinsurance failure may ultimately impact on policyholders, transmitted via their insurer); furthermore, as reinsurance is such a global business, the risks ceded or retroceded to Irish-authorised reinsurers can originate with policyholders based anywhere in the world. In this context, we believe that reinsurer failure should be approached quite distinctly from insurer failure, as certain of the primary concerns driving the implementation of a resolution framework (policyholder protection, limited supply of particular insurance lines) do not directly arise. We believe that the

appropriate resolution approach for reinsurers, in conjunction perhaps with the Write-down of Capital Instruments and Conversion of Eligible Liabilities as described in the Consultation Paper, would be for cedants of a reinsurer in resolution to be subject to write-downs of their receivables.

4. As a further complication, it should also be noted that insurers may write some level of inwards reinsurance, which might be material, in addition to their direct insurance business. Some thought may need to be given to the status of reinsurance creditors as opposed to other creditors in this specific context.

5. While the Consultation Paper supports the principle of proportionality at a high level, we believe it would be helpful if it was stated explicitly that resolution planning measures would not be applicable to the captive (re)insurance sector, given the nature of the business models involved.

6. We note the focus in the General Background section (Table 2 on page 6 in particular) on the scale of cross-border business being written by Irish (re)insurers into other EEA states. This no doubt reflects a concern about the possible impact of failures of Irish (re)insurers being greater than the domestic market might involve, with associated implications for the public finances. We believe that this level of cross-border business demonstrates Ireland's success in establishing itself as a major (re)insurance centre. The risks associated with this cross-border success might ideally be mitigated by a fully harmonised system of insurance guarantee schemes across the EEA, but we acknowledge that this remains some way off in the context of current European political realities.

Specific questions posed in the Consultation Paper

3.1 Resolution Objectives

1. Should any resolution objectives and the basis for completing a resolution action under a new domestic framework be aligned with the principles set out in the FSB's Key Attributes of Effective Resolution Regimes as applicable to the insurance sector and EIOPA's recommendations contained within its Opinion on the Review of Solvency II?

   William Fry Response: We believe that the most important alignment that must be achieved in any domestic framework is with objectives set down by the European Commission in its Proposed Directive. We note that the work of both the FSB and EIOPA is cited in the current draft of the Proposed Directive. Within that context, William Fry supports the objectives listed in Section 3.1 of the Consultation Paper.

3.2 Scope of Application

2.

   a) Should the proportionality principle be applied with regard to defining the insurers that are in-scope for resolution planning?

   William Fry Response: Yes, this is very important and we welcome the positive approach to proportionality apparent in the Consultation Paper. The explicit statement that before-the-event resolution planning will apply to a smaller subset of (re)insurers than are already required to prepare pre-emptive recovery plans seems appropriate. Aside from the question of scope, we also believe that the proportionality principle should be applied to the depth and content of the resolution plans themselves. Attempting to pre-empt a very wide range of failure circumstances and scenarios is unlikely to add significant value and resolution plans should focus in a succinct way on credible resolution actions.

   b) Should the Central Bank's PRISM impact ratings be used as a guide when considering the scope of application?

   William Fry Response: PRISM impact ratings appear to be a sensible starting point, and it doesn't seem unreasonable that, say, all High (and Ultra-High) rated undertakings would be within scope for resolution planning.

   c) Should third country branches be considered within the scope of application of relevant provisions of any envisaged domestic framework?

   William Fry Response: Given that any third country branch of an insurance company in Ireland can only conduct business with Irish policyholders, we believe that third country insurance branches operating within Ireland should be in scope and application and operation of regulation 299 of the Solvency II Regulations should be considered in that regard. However, there will ultimately be limitations to the resolution and restructuring of any third country branch as the head office, which will be located in a non-EEA member state, in all likelihood will be subject to its own resolution process which may give rise to recognition and conflicts of laws issues. Ultimately, any resolution scheme involving a third country insurance branch would need to be carefully drafted in order to recognise the additional complexities that would arise where resolution planning was commenced because of conflict of laws issues.

   Furthermore, third country branches in Ireland of reinsurance companies (noting that none exist at the time of writing) should be considered separately from those of insurance companies, noting our general comments about reinsurance as set out under point 3. of "Key Considerations" above.

3.3 Public Interest Assessment in the deployment of resolution tools

3.

a) Should a public interest assessment (PIA) be used to ensure that the deployment of resolution tools would be on an exceptional basis, i.e. for the few rather than the many?

William Fry Response: First of all, we agree fully with the principle that resolution tools would be deployed on an exceptional basis. However, we have concerns that the circumstances in which resolution tools may be activated is inadequately addressed in the Consultation Paper, which in particular does not consider the instigation of resolution within the context of existing measures under the Solvency II Regulations and other relevant legislation (as discussed in point 2. under "Key Considerations" above). It should be clearly stated in any future (re)insurance resolution framework that resolution tools cannot be deployed until it is no longer reasonable to restore a (re)insurance undertaking to compliance with its MCR / SCR. In principle, the idea of a PIA as put forward in the Consultation Paper is not unreasonable, but the criteria to be applied in carrying out such a PIA would need to be explicitly defined. Furthermore, the timescale required to complete a PIA would need to be considered; the Consultation Paper does suggest that the PIA might be begun pre-emptively, well in advance of any failure event, and that is reasonable. Nonetheless, in certain circumstances the deployment of resolution tools may be time-critical. Any processes (such as finalising a PIA) required before the resolution authority could use appropriate tools would need to be capable of being completed quickly and accurately. Finally, it will be important that there are appropriate checks and balances built into any resolution framework to ensure that there is a fair and objective process to be followed before the implementation of any resolution tools.

b) Are there sectoral specific considerations that should be taken into account when determining the public interest rule for deploying resolution tools?

William Fry Response: As discussed in point 3. under "Key Considerations" above, we believe that different criteria should be developed for deploying resolution tools for reinsurers as opposed to insurers, reflecting the absence of policyholders and the likelihood that substitutability will be less of an issue.

3.4 Resolution Tools & Powers

4.

a) Would a resolution toolkit be of benefit to the resolution authority in seeking to protect policyholders in situations where liquidation or administration may not offer the same level of protection?

William Fry Response: We believe that the value of a resolution toolkit of the type set out in the Consultation Paper is to widen the options available in the circumstances of a (re)insurer failure. As set out in point 2. under "Key Considerations" above, we do not believe that the proposed resolution tools necessarily deliver a superior measure of policyholder protection than is available under existing mechanisms. That said, an enhanced resolution toolkit will provide greater flexibility to the resolution authority as to the appropriate measures to take having regard for the circumstances. It should also result in speedier resolution outcomes and avoid prolonged periods of uncertainty which would otherwise be of concern for policyholders.

b) Are the resolution tools proposed in this consultation document appropriate to the Irish insurance sector, or are there other options that should also be considered?

William Fry Response: We believe that the tools described (including the Ancillary Resolution Powers and Obligations set out on page 17 of the Consultation Paper) are appropriate, once deployed in a fair and proportionate manner. We understand that certain of these measures are already available in other jurisdictions and it would be a useful exercise to undertake some analysis of how these measures operate in practice in those jurisdictions. We would also observe that the Bridge Insurer option could be complicated to exercise in practice. It is described as being a temporary measure but the cost and complexity of establishing and operating it may outweigh benefits. That said, it warrants further analysis as a possible resolution tool. Please note also our proposal in relation to the resolution of reinsurers, as set out under point 3. of "Key Considerations" above.

c) Would the use of a write-down and conversion tool in limited circumstances be a means to facilitate burden-sharing, with the cost of failure borne by the insurer's investors in the first instance rather than by policyholders, the broader industry, or by the public/taxpayer?

William Fry Response: Potentially yes, although of course it will depend on the exact circumstances of a particular failure and it should not be assumed that the availability of this tool would always insulate policyholders and the broader public from bearing some part of the costs involved.

3.5 Resolution Planning

5.

a) Should a resolution plan be prepared on a before the event basis for insurers where there may be a public interest in using resolution tools in the event of failure?

William Fry Response: Yes, noting the importance of establishing clear and transparent criteria under which to assess the public interest.

b) Do you agree that this plan be developed by the resolution authority? Or do you see a role for the insurers in developing such plans?

William Fry Response: We believe it is in line with international best practice for the resolution authority to have primary responsibility for developing the resolution plan. Insurers should have an obligation to provide information necessary to the preparation of the plan (noting our comments that the plan should be succinct and focused on credible actions) and should have a right to review and enter into constructive dialogue with the resolution authority on the plan.

c) Where an Irish authorised insurer is a subsidiary of an international regulated entity, should the resolution authority liaise with the resolution/competent authority of the parent entity for resolution planning purposes?

William Fry Response: We believe that such liaison should be facilitated in any resolution framework, subject to implementing appropriate confidentiality provisions (particularly where the parent entity is based in a non-EEA jurisdiction).

6.

a) Should insurers, which may require resolution tools in the event of failure, hold an additional buffer of capital or eligible debt to enhance loss absorbing capacity and minimise the risk of costs being borne by policyholders or the public?

William Fry Response: We believe in the strongest terms that a future resolution framework should not impose additional capital or eligible debt requirements on (re)insurers. We note in particular that the EU Commission (in its "Questions and Answers" document accompanying the Proposed Directive: https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_4764) states: "*A specific requirement to create additional internal loss-absorbing capacity in the form of bail-in-able instruments that (re)insurers would have to issue and service was regarded as disproportionate and has therefore not been proposed.*" We fully agree with this position and propose that any requirement for additional loss-absorbing capacity under an Irish resolution framework should be dropped.

b) What is the anticipated impact of the holding of additional capital buffers on the Irish market in terms of costs and supply?

William Fry Response: We believe the primary impact would be to make Ireland a less attractive location for (re)insurers than other EEA states and could only have a negative effect on competition and the future supply of insurance to the Irish market.

4 Administration and Winding-Up

7.

a) In order to offer greater protection to policyholders, is there merit in amending the existing insolvency legislative processes? And if so, what would be the key issues of concern to stakeholders?

b) Are there other enhancements that should be considered to strengthen the administration and winding-up processes?

William Fry Response: All of our views in relation to this area of the Consultation Paper are set out in Point 2. under "Key Considerations" above

5 Resolution Funding

8.

a) In the event of resolution actions requiring additional financing, should the ICF be utilised or a separate resolution financing facility established?

William Fry Response: We believe that the most appropriate approach would be to leave the ICF as it is to run off historic obligations and create a new resolution financing facility to deal with all cases that would be instigated after the implementation of the proposed resolution framework. Furthermore, we believe that the future facility should apply only to direct insurers, i.e. allowance should not be made for a financing facility in respect of reinsurers, given our proposal as to how reinsurer resolution should be addressed.

b) Should such a fund be built up using contributions collected on a before the event or after the event basis?

William Fry Response: While before-the-event may appear attractive, we believe there is an issue with moving from existing after-the-event arrangements to before-the-event, as this would lead to a particular cohort of policyholders for a period of time paying both for past events and potential future ones. For this reason, we favour continuing an after-the-event approach for the foreseeable future.

c) Should arrangements be put in place to ensure any levy contributions are not directly imposed on the policyholders?

William Fry Response: First of all, we believe that it is quite problematic to envisage implementation of a mechanism that would insulate policyholders from the impact of a levy imposed on the insurance sector to meet the costs of a failure, whether directly or indirectly. We believe that the best available approach is the clear and transparent one of separately identifying the quantity of such levies within policyholder premiums, making it clear that this element of insurance pricing is not the fault of the underwriter and that it applies consistently across the market, irrespective of the underwriter chosen.