

## Response to EIOPA consultation on the statement on supervisory practices and expectations in case of breach of the Solvency Capital Requirement

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### Questions

**Q1** *The European Insurance and Occupational Pensions Authority (EIOPA) provides this Supervisory Statement on the basis of Article 29(2) of Regulation (EU) No 1094/2010 to promote common supervisory approaches and practices.*

The industry would welcome some clarity and transparency on the list of the European Insurance and Occupational Pensions Authority's (EIOPA) supervisory and convergence tools: for example, on EIOPA's website.

Transparency regarding the rationale leading to the choice of one tool rather than another would also be welcome during public consultations.

**Q2.** *This Supervisory Statement is based on Directive 2009/138/EC (Solvency II) and addressed to the competent authorities, as defined in point (i) of Article 4(2) of Regulation (EU) No 1094/2010*

As EIOPA duly notes, guidance tools – such as supervisory statements or guidelines – are addressed to national supervisory authorities (NSAs) and not undertakings. Therefore, the wording should avoid targeting undertakings and instead highlight EIOPA's expectations regarding NSAs' actions.

For example, sentences such as "Insurance and reinsurance undertakings should..." could be replaced by "Supervisory authorities should expect from insurance and reinsurance undertakings to...".

**Q3.** *The supervisory practices addressing the supervisory ladder are necessarily flexible and should consider the specific situation of the insurance or reinsurance undertaking. However, it is important that when certain triggers are reached, such as non-compliance with the Solvency Capital Requirement (SCR), a minimum convergent approach is applied in order to avoid supervisory arbitrage.*

It must be clear that convergence of supervisory practices focuses on supervisory actions, and not on equal outcomes for all companies. Fully taking into account specific situations is crucial for a successful recovery.

However, a clarification that non-compliance with the SCR starts (in accordance with Article 138 of the Directive) when the SCR ratio is below 100%, and not before – followed by a minimum level of harmonisation within EU member states – would be highly appreciated. Currently some NSAs defined their national common practice differently and already start increased supervisory measures above the SCR ratio of 100%, which is not within the meaning of the Article 138 of the Directive and leads to an uneven playing field.

**Q4.** *This has always been an area of extreme importance. However, during the last 4 years (2016-2019) only few breaches of the SCR have happened. There were 12 undertakings which have had a breach of the SCR for a period of two consecutive years, which represents less than 0,5% of all undertakings subject of SII. The breaches are spread between 6 Member states.*

Among these cases of SCR breach, indicating the number of companies that have recovered vs leading to effective failure would provide a better insight.

**Q5.** *Since the Covid-19 pandemic has emerged at the beginning of 2020, the world is facing this new risk and more frequent breaches of the SCR could be observed in the future. European undertakings have demonstrated resilience to the impact of the Covid-19 pandemic until now, however, the current environment amplifies the risks of non-compliance*

See comment to para 3.

**Q6.** *The ongoing uncertainty can lead to breaches of SCR in the future, in which case the Solvency II supervisory ladder of intervention allows supervisory authorities to take early actions including among others the approval of a recovery plan.*

The word “can” should be changed to “could” to reflect the uncertainty of this hypothesis.

**Q7.** *In this environment and considering a potential increase of non-compliance cases it is of particular importance to ensure consistency in the way the recovery plans are developed, assessed and approved.*

See comment to para 3.

**Q8.** *The aim of this Supervisory Statement is to promote supervisory convergence in the application of the supervisory ladder, in particular addressing the recovery plan required in case of breach of the SCR. This Supervisory Statement is developed to be applicable at any time. However, one specific paragraph is included addressing supervisory expectations on recovery plans to be developed in the context of the Covid-19 pandemic*

See comment to para 3.

## OBSERVATION OF NON-COMPLIANCE

**Q9.** *Insurance and reinsurance undertakings should consider as the date of non-compliance with the SCR the date on which non-compliance with the SCR has been observed through their on-going monitoring. Accordingly, supervisory authorities should consider as the start of the two-months period - prescribed for the submission of the recovery plan - the date of observation of a breach of the SCR as indicated by the undertaking in its notification to the supervisory authority, regardless of quarterly/annual reporting.*

A reference to Article 138.2 of the Directive in the first sentence of this paragraph would be welcome, to clarify which part is an existing legal requirement and which part constitutes new guidance.

Moreover, this sentence could be interpreted in many ways and should be clarified. The Regulation does not say that NSAs should be notified if internal monitoring shows that the SCR may be breached (in the near future). It should be clear that notification is necessary if an actual breach has been observed on (the most recent) historical data. It is important to not go beyond the current framework and trigger any supervisory actions before the SCR is breached, notably because:

- When internal monitoring shows that the SCR could be breached, companies have a range of possible actions and measures they can take to prevent it.
- Companies may test a new strategy (eg a new asset mix) and see that it would result in a breach of the SCR, and so decide not to implement it. This should not be considered as a risk of a breach.

Insurance Europe would like to stress that, in some jurisdictions, NSAs go beyond the Solvency II framework and impose early intervention measures: for example, in the form of a recovery plan. This creates an unlevel playing field, and should be prevented through the provision of clear guidance or peer reviews.

It is important to reiterate that Solvency II already provides very high levels of policyholder protection and safeguards that must be duly considered.

Also see comment to para 3.

**Q10.** *In case an undertaking did not detect and hence did not inform the supervisory authority about the breach of the SCR and this non-compliance is first established by the supervisory authority (e.g. during an on-site inspection), the date of observation of a breach and therefore starting date for submitting a realistic recovery plan should be the date indicated by the supervisory authority in its notification to the concerned undertaking <sup>[1]</sup>.*

<sup>[1]</sup> *If an undertaking fails to detect a breach of the SCR, this issue should be assessed and followed by the supervisory authority, in particular from a governance perspective.*

NA

## REQUEST OF A RECOVERY PLAN

**Q11.** *Insurance and reinsurance undertakings are required to submit to the supervisory authorities a realistic recovery plan within two months upon the observation of a breach of the SCR.*

See comment on para 9.

**Q12.** *If the undertaking adopted prompt recovery measures which restored compliance with the SCR within two months and these measures are considered by the supervisory authority as adequate to preserve a sustainable solvency situation, including an assessment of a forward-looking perspective of the solvency position, the supervisory authority may consider that the submission of recovery plan is not needed. The undertaking should at least engage in a supervisory dialogue and submit to the supervisory authority, within the same period of two months, relevant and adequate information to allow a proper assessment of the causes for the non-compliance, the solvency situation, including on the assumptions, scenarios and measures supporting the sustainability of the restored solvency position. Based on this information, the supervisory authority should assess if additional information, measures or a recovery plan are needed.*

Insurance Europe welcomes the clarification that NSAs can assess whether there is still a need for a recovery plan when compliance has been restored within the two month period. This is a good example of the application of proportionality.

#### CAUSES OF NON-COMPLIANCE

**Q13.** *Supervisory authorities should request from insurance and reinsurance undertakings, as part of the recovery plan, an analysis of the causes of non-compliance and of any shortcomings in their risk management system, including possible inadequacy of:*

- a) *internal risk appetite;*
- b) *quantitative or qualitative indicators/measures;*
- c) *overall risk tolerance limits;*
- d) *metrics used within the risk management system to measure risks;*
- e) *stress test framework;*
- f) *monitoring process.*

The industry agrees that introspection as to why the SCR was breached (ie an SCR ratio below 100% in accordance with Article 138 of the Directive) is necessary to provide appropriate solutions. However, considering the purpose of the plan, the focus should be on restoring compliance with the SCR. An in-depth analysis of the roots and causes to the breach would, of course, be necessary, but should not be part of the plan. Lack of a detailed analysis should not lead supervisors to systematically reject a plan that must be submitted in a constraint period.

Moreover, EIOPA seems to only consider the breach to be the result of failed risk management. However, a breach of the SCR could also be the result of an external event. Therefore, Insurance Europe proposes to change the text as follows:

“of any **possible** shortcomings in their risk management system, including possible inadequacy of:”

**Q14.** *If the causes of the breach of the SCR have impact also on business operations of the undertaking, in particular with regard to critical processes and functions (such as policy administration, claims handling, investment management, reinsurance arrangements or information technology services), the undertaking should indicate, as part of the recovery plan, how it intends to ensure the appropriate day-to-day operation, including governance aspects.*

NA

## ASSUMPTIONS AND SCENARIOS OF THE RECOVERY PLAN

**Q15.** *Insurance and reinsurance undertakings should take at least the following into account when preparing their recovery plan in accordance with Article 142 of Solvency II, considering the proportionality principle, the level of non-compliance with the SCR and the possible duration of the deterioration of the undertaking's financial conditions:*

a) *the forecast balance sheet and estimates should be based on realistic assumptions both in relation to the economic scenarios and business of the undertaking, supported by justifications;*

a) The mention of the proportionality principle is welcome.

**Q15.** *b) the assumptions should be tested for the different business lines, involving the key functions, and where applicable and appropriate the parent company, subsidiaries and branches;*

c) *the scenarios should consider any foreseeable and probable relevant adverse events that can occur in the forecasted period considering undertaking's business model and strategy;*

d) *the forecast balance sheet and estimates should reflect a recalculation of the future cash-flows considering the economic scenarios defined;*

e) *the forecast balance sheet and estimates should reflect an assessment of the business exposures related to the risk coverages or guarantees of the insurance products and explain how that assessment was reflected in the valuation of liabilities; this should include the assessment of probable adverse events and policyholder behaviour including lapses, cancellations, increasing claims and potential litigation over compensation disputes, depending on the risk exposures if justified by the economic environment;*

f) *in case the forecast balance sheet and estimates reflect the implementation of management actions leading to investment gains, reduction of expenses/commissions or release of technical provisions, those actions should be consistent with the business strategy and with any re-calculation of the technical provisions, loss absorbing capacity of deferred taxes or loss absorbing capacity of technical provisions;*

g) *following the assessments referred to in the previous points, the expected future profits should be reassessed based on a revised plan for the next business period(s).*

NA

**Q16.** *When preparing recovery plans in the context of the Covid-19 pandemic, undertakings should take the following specific points into account in addition to Point 15:*

a) *realistic assumptions both in relation to the economic scenarios and business of the undertaking are expected to reflect a possible economic downturn and its impact on the undertaking's business models including premiums estimates, to consider (i) volatility of the financial markets, (ii) changes in yield curves, (iii) probable mass downgrades of credit ratings*

b) *the economic scenarios should consider how the Covid-19 pandemic might evolve including possible further waves;*

c) *the forecast balance sheet and estimates should reflect an assessment of the business exposures related to the risk coverages or guarantees of the insurance products, including possible new products launched and/or products stopped being commercialised or substantially changed in light of the Covid-19 pandemic, and explain how that assessment was reflected in the valuation of liabilities. This should include the assessment of possible decrements and policyholder behaviour including lapses, cancellations, increasing claims and potential litigation over compensation disputes, depending on the risk exposures.*

a) NA

b) The industry wishes to highlight the importance of supervisory dialogue in making those assumptions. The dialogue should help to address any concerns that the NSA may have regarding appropriate scenarios ahead of the formal approval process of the recovery plan.

c) NA

**Q17.** *Supervisory authorities should assess the reliability of the assumptions and methods based on the rationale provided by the undertakings and considering the marketability of assets under the different scenarios, plausibility of valuations, risk concentrations and the undertakings' business model.*

As for any other context, insurers must make assumptions and design realistic scenarios to project future solvency, and to assess their reliability.

**Q18.** *Concerning projections for cross-border underwriting activities, supervisory authorities should exchange information to capture local specificities, in particular to assess the reliability of the economic scenarios for the cross-border business and enhance a common understanding of the economic scenarios being considered and of the solvency position of the undertaking.*

The industry wishes to highlight the need for fast and efficient cooperation between NSAs to avoid undue delays on the approval of the recovery plan. NSAs should make use of the cooperation forums mentioned in para 19 in those cases.

**Q19.** *Supervisory authorities should make use of European cooperation forums, where appropriate, such as colleges of supervisors and cooperation platforms to foster convergence of approaches across Member States.*

NA

## **RECOVERY MEASURES**

**Q20.** *Insurance and reinsurance undertakings should detail the realistic and timely recovery measures to restore their solvency position and sustain it in a medium to long-term period, also considering the internal risk of tolerance limits established in the undertakings' risk appetite framework. Changes and improvements for the risk management system to address possible shortcomings as referred in Point 13 should be detailed.*

The industry notes that a review of risk management systems takes time. In many instances, it could be more appropriate to plan a more in-depth analysis through internal audits or reviews in the context of a recovery plan to identify shortcomings, rather than to already propose rushed changes.

Moreover, the purpose of the plan is to establish how to restore compliance with the SCR within the prescribed time. An extension to a more prolonged period (medium to long-term) does not have grounds in the Solvency II Directive.

**Q21.** *The recovery plan should document the feasibility of the recovery measures, including foreseeable and probable relevant adverse events and explain:*

- a) *the impact on the undertaking's solvency and liquidity;*
- b) *the timeline for implementation and the expected time needed to observe the benefit of the measure;*
- c) *where applicable, past experience, interconnectedness' implications, changes to the business model and to the risk profile*

NA

**Q22.** *Undertakings should include in the recovery plan a comprehensive implementation plan, breaking it down into specific actions and timelines for each step with a feasibility assessment having in mind the potential situation of the market, the extent to which implementation depends on third parties, risks, mitigation measures and where relevant alternatives.*

NA

**Q23.** *Supervisory authorities should assess if there is sufficient evidence that the proposed recovery measures can be implemented in a timely and effective manner in the current environment and over the recovery period. Recovery measures without a properly described and justified impact and feasibility assessment should not be considered reliable.*

NA

**Q24.** *Supervisory authorities should further consider contagion effects, including cross-sectoral and possible procyclical effects.*

NA

## **RECOVERY PERIOD**

**Q25.** *Insurance and reinsurance undertakings can foresee in the recovery plan a period longer than six and up to nine months to restore compliance, explaining the reason why six months would not be enough.*

This flexibility, based on an assessment of the situation and of the risks, is welcome and is a good implementation of proportionality.

**Q26.** *When a period longer than six months (up to nine months) is requested by the undertaking in the recovery plan, the supervisory authority should, as a first step, review the recovery plan<sup>[2]</sup>, evaluate the recovery measures, assess the reasons for the additional time requested, assess if the time proposed is consistent with the implementation of such measures and if the market conditions allow for such implementation.*

<sup>[2]</sup> *If the extension of the recovery period is requested before the recovery plan is formally submitted, then at least the main points of the plan need to be communicated to the supervisory authority.*

See comment on para 25.

**Q27.** *In case the extension is requested towards the end of the sixth months of the recovery period, the supervisory authority should consider whether sufficient progress or positive outlook is observed during the initial recovery period, whether the extension is in the best interests of policyholders and whether there is not a significant risk for the breach of the Minimum Capital Requirement.*

See comment on para 25.

## MONITORING AND NON-COMPLIANCE AT THE END OF THE RECOVERY PERIOD

**Q28.** *After a recovery plan has been submitted, insurance and reinsurance undertakings should notify supervisory authorities of any significant change in the extent of the solvency or liquidity shortfall.*

NA

**Q29.** *If compliance with the SCR is not restored within the prescribed recovery period, the supervisory authorities should impose additional measures. These measures may vary depending on the specific situation and national laws and should be proportionate, taking into account in particular (i) the level of non-compliance with the SCR, (ii) the duration of the deterioration of the undertaking's financial conditions and (iii) the sustainability of the applied measures by the undertaking to restore its solvency for a medium to long time horizon. These measures should always consider the interests of policyholders, which may justify restrictions to writing new business and/ or constraints to the free disposal of assets. Depending on supervisory powers under national laws, supervisory authorities should also consider subjecting certain operations to prior supervisory approval or impose specific governance changes or transactions*

The industry would welcome a clarification that, according to Article 138 of the Directive, compliance may be considered as non-restored only when the SCR ratio remains strictly below 100%.

**Q30.** *If the non-compliance situation has not improved or if at any time the supervisory authority concludes that the measures in place will not allow the recoverability of the solvency position in a sustainable manner and that the interests of the policyholders are not properly safeguarded, the supervisory authority should consider to withdraw the undertaking's authorisation in accordance with the conditions of Article 144 of Solvency II.*

The importance of supervisory dialogue leading to the conclusion that the measures are not sufficient should be highlighted.

## QUESTIONS TO SUPPORT THE IMPACT ASSESSMENT

*In preparing the Statement on Supervisory practices and expectations in case of breach of the Solvency Capital Requirement, EIOPA took into consideration the general objectives of the Solvency II Directive, namely:*

- *adequate protection of policyholders and beneficiaries, being the main objective of supervision;*
- *financial stability; and*
- *proper functioning of the internal market.*

*The drafting of the Statement is also guided by EIOPA's statutory objectives, as reflected in the Regulation of the Authority, notably:*

- *improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision,*
- *ensuring the integrity, transparency, efficiency and orderly functioning of financial markets,*
- *preventing regulatory arbitrage and promoting equal conditions of competition,*
- *ensuring the taking of risks related to insurance, reinsurance and occupational pensions activities is appropriately regulated and supervised, and*
- *enhancing customer protection.*

*To analyse the impact of the proposed supervisory convergence measures, the final impact assessment to be developed ex-post this public consultation foresees that a baseline scenario is applied as the basis for comparing supervisory convergence options. This will help to identify the incremental impact of each action considered in this supervisory statement. The aim of the baseline scenario is to explain how the current situation would evolve without additional intervention creating level playing field in the application of the supervisory ladder, in particular addressing the recovery plan required in case of breach of the SCR. The answers of the four last questions in the survey will be taken into account when assessing the impact of the suggested convergence practices.*

**Q31.** *Insurance and reinsurance undertakings should consider as the date of non-compliance with the SCR the date on which non-compliance with the SCR has been observed through their on-going monitoring and they are required to submit to the supervisory authorities a realistic recovery plan within two months upon the observation of a breach of the SCR. In case non-compliance being first detected by the supervisory authority, the date of observation of a breach and therefore starting date for submitting a realistic recovery plan should be the date indicated by the supervisory authority in its notification to the concerned undertaking. Is the suggested approach in relation to the observation of non-compliance expected to achieve more convergence in terms of undertaking's internal functioning, interaction with the NCAs and level playing field a national and European level?*

Yes. The clarification that "observed" relates to on-going monitoring, and not regular reporting, and how to deal with non-compliance being detected by the NCA, should foster convergence in supervisory practices.

**Q32.** *If the undertaking adopted prompt recovery measures which restored compliance with the SCR within two months in a sustainable matter considering as well the forward-looking perspective, the supervisory authority may consider that the submission of recovery plan is not needed. The undertaking should at least engage in a supervisory dialogue and submit to the supervisory authority, within the same period of two months, relevant and adequate information to allow a proper assessment of the causes for the non-compliance, the solvency situation, including on the assumptions, scenarios and measures supporting the sustainability of the restored solvency position. Is the suggested convergence approach expected to limit the burden of preparing a recovery plan when considered as not needed by the NCA and to support the dialogue with the supervisor to agree on a plan for preserving stable restored solvency position and support the level playing field a national and European level?*

Yes, the proposed flexibility to allow an NSA to no longer request a recovery plan when it deems it unnecessary is welcome. It is a risk-based application of proportionality and fosters supervisory dialogue rather than a burdensome “tick-the-box” exercise.

**Q33.** *In the course of preparing recovery plan in accordance to Art. 142 of the Solvency II Directive undertakings should take into account additional specific points in the context of the Covid-19 pandemic, such as: (i) reflecting a possible economic downturn and its impact on the undertaking’s business models in the economic scenarios and the business plans; (ii) considering evolvement of the Covid-19 pandemic; (iii) reflecting on possible new products launched and/or products stopped being commercialised or substantially changed in light of the Covid-19 pandemic in the valuation of liabilities. Is the suggested convergence approach in the course of preparation of the recovery plan in the context of Covid-19 expected to help undertakings to better incorporate the expected impact of Covid-19 while assessing the forward looking solvency position?*

While restating the common rules in the context of COVID-19 may help NSAs to adopt the same approach and limit gold plating, insurers must always take these considerations into account within any economic context

**Q34.** *Insurance and reinsurance undertakings can foresee in the recovery plan a period longer than six and up to nine months to restore compliance, explaining the reason why six months would not be enough. Is the suggested approach in relation to the extension of the recovery period (when requested at its beginning and towards its end) expected to bring more convergence in terms of undertaking’s effective continuous work on recovering the solvency position, the interaction with the NCAs and level playing field a national and European level?*

Yes, formally allowing NSAs to extend the recovery period where appropriate is likely to encourage all NSAs to apply proportionality, including NSAs that did not feel legally allowed to deviate from the six-month period for any reason.

**Q35.** *Is there any other area regarding the supervisory practices and expectations in case of breach of the Solvency Capital Requirement where you believe further supervisory convergence is needed?*

NA