17 February 2021

EIOPAs Consultation Paper on Statement on supervisory practices and expectation in case of breach of SCR

INTRODUCTION

1. 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 supervisoryapproaches and practices.

AMICE welcomes the opportunity to comment on the Statement on supervisory practices and expectations in case of breach of the SCR.

The supervisory statement lists extensive requirements in order to promote common supervisory approaches, however it should be made clear that not every one of these will necessarily apply in every case; there should be sufficient flexibility to ensure that the supervisory measures taken in case of breach of the SCR are tailored to the particular company and their specific situation.

2. 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.

N/A.

3. 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.

Solvency II was designed to provide supervisors with a supervisory ladder of intervention. However, supervisory authorities in some jurisdictions are requesting firms to hold a solvency ratio above 100% and already start supervisory measures before the SCR has been breached.

4. 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.

No comment.

5. 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.

We agree that the Covid-19 pandemic has not indicated weaknesses or deficiencies in capital or management of insurance companies However, there is no evidence that the current environment amplifies the risks of non-compliance. The latest available Solvency II ratios (i.e Q4 ratios) confirm that there is not such a trend.

6. 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.

There is no evidence that in the near future there would be an increase of SCR breaches. The insurance sector has proven to be resilient over the Covid-19 crisis.

7. 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.

There should be sufficient flexibility to ensure that the supervisory measures taken in case of breach of the SCR are tailored to the particular company and its specific situation.

8. 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.

We do not see the added value of making a specific reference to the Covid-19 pandemic. We would rather prefer to keep this Supervisory Statement at a more general level.

OBSERVATION OF NON-COMPLIANCE

9. 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.

We do not agree on using the on-going monitoring to identify the date of non-compliance with the SCR since simplifications and management data could be used leading to evaluations not aligned with the quarterly/annual reporting. We believe that the on-going monitoring figures should be used by the undertaking's management as early warning indicators. The start of the two-months period should be linked to the quarterly/annual reporting.

10. 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 [1].

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

See comment above.

REQUEST OF A RECOVERY PLAN

11. 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.

No comment.

12. 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.

No comment.

CAUSES OF NON-COMPLIANCE

13. 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.

Another reason could be the existence of the conditions for exceptional circumstances as a result of persistent low interest rate environment; a high-impact catastrophic event and a sharp, steep and unforeseen fall in financial markets as defined in Article 138 (4). We understand that the recovery plan should assess the causes of non-compliance but the focus should rather be on the measures for restoring compliance.

14. 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.

We understand that the recovery plan should assess the causes of non-compliance but the focus should rather be on the measures for restoring compliance.

ASSUMPTIONS AND SCENARIOS OF THE RECOVERY PLAN

15. 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:

In our view the reference to "at least" should be deleted. Moreover, EIOPA goes far beyond the scope of the recovery plan defined in article 144 of the Solvency II Directive which requires estimates of management expenses (current general expenses and commissions), estimates of income and expenditure of direct business and reinsurance a forecast balance sheet, estimates of the financial resources to cover the technical provisions and the SCR and MCR and the overall reinsurance policy.

We believe that the request of information should be scaled to the magnitude of the SCR breach.

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;

We believe that the request of information should be scaled to the magnitude of the SCR breach.

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;

We believe that the request of information should be scaled to the magnitude of the SCR breach.

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;

EIOPA Supervisory Statement states that 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; EIOPA seems to imply that insurers in breach of the SCR would have to consider the same set of scenarios / stresses than in the ORSA; However, an update of the ORSA would not be possible given the short timeline to submit the recovery plan.

We believe that the scenarios should be limited to the main and relevant adverse events. We therefore request that "*any foreseeable and probable relevant adverse events"* is replaced by *"a relevant number of foreseeable and probable relevant adverse events"*. The most recent ORSA may cover part of the recovery plan and can be used for that purpose if needed but it should be scaled to the limited timeframe (i.e 2 months). It should be reminded that the aim of the recovery plan is the re-establishment of the level of eligible own funds covering the SCR or the reduction of the risk profile to ensure compliance with the SCR within a required timeframe.

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

We believe that the request of information should be scaled to the magnitude of the SCR breach.

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;

We believe that the request of information should be scaled to the magnitude of the SCR breach.

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;

We appreciate the fact that management actions are being considered.

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).

We believe that the request of information should be scaled to the magnitude of the SCR breach.

Recovery plans in the context of the Covid-19 pandemic

16. 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:

We consider that the three conditions to be met in order to declare an exceptional adverse situation according to Article 138(4) can be found following the Coronavirus outbreak. However, we do not see the added value of making a specific reference to the Covid-19 pandemic. We would rather prefer to keep it at a more general level.

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 and (iv) possible positive correlation of some asset classes under the current environment;

EIOPA seems to assume that the consideration of the Covid-19 crisis will have a negative impact in the economic scenarios and other assumptions of the insurer´s recovery plan. However, EIOPA has analysed in its Opinion of the Solvency II review and other publications the impact of Covid-19 in the insurance sector and seems to reach more positive conclusions than in this EIOPA Statement (see below).

Regarding item (iii) probable mass downgrades of credit ratings

EIOPA assessed the general market movements concerning corporate bond downgrades and defaults as a result of the Covid-19 crisis. Based on the evidence collected so far, EIOPA pointed out that we are not in presence of a mass downgrade/default scenario. Although a significant increase in the number of bond downgrades *and, to a lesser extent, the number of defaults could be observed in the early months following the start of the pandemic crisis, those figures have receded to much more moderate numbers in recent months.*

Regarding item (iv) possible positive correlation of some asset classes under the current environment;

EIOPA also pointed out that the data from March and April 2020 showed stronger spread widening and decreasing interest rate rates. This would have given rise to a high correlation between interest rate and spread risk. However, taking the entire data from 2020 up to the end of August into account, would have led to a moderate correlation of 0.33 The new data from May until August 2020 showing a significant decrease in credit spreads, has in particular lead to significant decrease in this simple correlation calculation.

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

See our answer to the question above. The principle of proportionality should also be considered.

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.

EIOPA has also pointed out in the different reports related to the Covid-19 crisis that lapse rates did not generally increase in response to the outbreak of the pandemic.

17. 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.

The principle of proportionality should also be considered.

18. 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 principle of proportionality should also be considered.

19. 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.

The principle of proportionality should also be considered.

RECOVERY MEASURES

20. 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 focus of the recovery measures should be on the re-establishment of the level of eligible own funds covering the SCR or the reduction of the risk profile to ensure compliance with the SCR within a required timeframe.

21. 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 tothe risk profile.

The principle of proportionality should also be considered.

22. 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.

A "restrictive" approach regarding the implementation plan broke down by specific actions and timelines could lead to unintended adverse economic consequences for insurance undertakings.

23. 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.

The principle of proportionality should also be considered.

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

The principle of proportionality should also be considered.

RECOVERY PERIOD

25. 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.

We believe that undertakings need to ensure that they put in place the necessary measures to comply with the capital requirements within a very limited timeframe of 6 to 9 months. In our view, supervisory authorities should not grant less time to recover than the one considered appropriate for policyholder protection. In any case, we believe that the length of the extension of the recovery period in normal circumstances should be modified to allow undertakings achieve a rapid re-compliance with the SCR. Mandating a re-compliance in the short time frame of 9 months may not be realistic.

26. 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[2], 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.

[2] If the extension of the recovery period is requested before the recovery plan is formally submitted, thenat least the main points of the plan need to be communicated to the supervisory authority.

Given that the extension of the recovery period in normal circumstances is limited to three months, the supervisory decision on granting an extension of the recovery period should be taken without delays. We suggest that it should not take longer than two or three weeks.

27. 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.

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

28. 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.

No comment

29. 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. This measure 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 supervisor should consider when imposing the additional measures, the ability of the insurer to remain on a going concern basis. We do not agree that it should be sufficient for an insurance undertaking to prove the sustainability of the measures to meet the SCR for a medium or longer time horizon. This is not in line with the Solvency II Directive.

EIOPA indicates that some measures such as underwriting new risks or measures regarding the insurer´s asset portfolio may be imposed. However, EIOPA should also consider the dialogue with the insurer concerned on the appropriateness of the measures and whether the measures will not worsen its solvency situation.

30. 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 authorization in accordance with the conditions of Article 144 of Solvency II.

This statement goes against article 144 of the Solvency II Directive which states that NSAs should withdraw the undertaking´s authorization when it does not comply with the Minimum Capital Requirement and the supervisory authority considers that the finance scheme submitted is not adequate or the *undertaking fails to comply with the approved scheme within three months from the observation of non-compliance with the MCR*.

Solvency II was designed to provide supervisors with a supervisory ladder of intervention. However, supervisory authorities in some jurisdictions are requesting firms to hold a solvency ratio above 100% and the SCR is perceived as the hard target. SCR should continue to be the standard protection against risks.

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 Regulationof the Authority, notably:

- **improving the functioning of the internal market, including in particular a sound, effective and consistentlevel of regulation and supervision,**
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- **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 isappropriately 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 actionconsidered 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 thesuggested convergence practices.

See comments above.

3.1 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 andthey 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 concernedundertaking. *Is the suggested approach in relation to the observation of non-compliance expected toachieve more convergence in terms of undertaking's internal functioning, interaction with the NCAsand level playing field a national and European level?*

See comments above.

3.2 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 leastengage 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 solvencyposition and support the level playing field a national and European level?***

See comments above.

3.3 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 inthe 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?***

See comments above.

3.4 Insurance and reinsurance undertakings can foresee in the recovery plan a period longer than six andup 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?***

See comments above.

3.5 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?

We believe that this supervisory statement should also cover the supervisory convergence regarding the application of Article 138 (4). This article states that NSAs may, in the event of exceptional adverse situations, *further extend the recovery period for the re-establishment of compliance with the SCR by a maximum period of 7 years* (the "exceptional adverse situations affect insurers representing a significant share of the market or affected lines of business, where undertakings fail to fulfil their SCR"). In order to extend the recovery period a significant number of companies in a market or LoB should have breached the SCR.

We can consider that the three conditions defined in Article 138 (4) were met following the

Coronavirus outbreak. However, the triggering of Article 138 (4) requires not only an NSA's request for extension but also that a significant number of companies in the jurisdiction asking for the request are in breach of the SCR.

The NSAs would also have to show that those insurers, who are in breach of the SCR, would not be able to recover within 9 months and that more time should be granted. The process to follow to obtain an extension could be long. Moreover, a trigger by EIOPA without the involvement of NSAs is not be possible. Once EIOPA has declared the existence of an exceptional adverse situation, it will only apply to the jurisdiction who request it.

As a result, the current wording of Article 138 has not proved adequate to provide the necessary relief in a crisis situation. Some amendments are needed so that the triggering of Article 138 releases pressure on the AMSB of insurers whenever their internal limits are breached.