

# **SUPERVISORY STATEMENT ON SUPERVISORY PRACTICES AND EXPECTATIONS IN CASE OF BREACH OF THE SOLVENCY CAPITAL REQUIREMENT**

EIOPA-BoS-21/281  
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European Insurance and  
Occupational Pensions Authority

## **1. Legal basis**

- 1.1. The European Insurance and Occupational Pensions Authority (EIOPA) provides this Supervisory Statement on the basis Article 29(2) of Regulation (EU) No 1094/2010<sup>1</sup>. This Article mandates EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union.
- 1.2. EIOPA delivers this Supervisory Statement on the basis of Directive 2009/138/EC (Solvency II).
- 1.3. This Supervisory Statement is addressed to the competent authorities<sup>2</sup>, as defined in Article 4(2) of Regulation (EU) No 1094/2010.
- 1.4. The Board of Supervisors has adopted this Supervisory Statement in accordance with Article 2(7) of its Rules of Procedure<sup>3</sup>.

## **2. Context and objective**

- 2.1. The supervisory practices addressing the supervisory ladder are necessarily flexible and should consider the specific situation of each 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 foster supervisory convergence.
- 2.2. This has always been an area of extreme importance. However, during 2016-2019 only few breaches of the SCR have happened<sup>4</sup>. 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 to Solvency II. The breaches are spread between six Member States.
- 2.3. 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 may amplify the risks of non-compliance.
- 2.4. The ongoing uncertainty could 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.
- 2.5. 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.

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<sup>1</sup> Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

<sup>2</sup> Notwithstanding the fact that specific points of this Supervisory Statement describe supervisory expectations for insurance and reinsurance undertakings, they are required to comply with the regulatory and supervisory framework applied by their competent authority based on Union or national law.

<sup>3</sup> Decision adopting the Rules of Procedure of EIOPA's Board of Supervisors, available at:

[https://www.eiopa.europa.eu/sites/default/files/publications/administrative/bos-rules\\_of\\_procedure.pdf](https://www.eiopa.europa.eu/sites/default/files/publications/administrative/bos-rules_of_procedure.pdf)

<sup>4</sup> In accordance with Article 138 of the Solvency II Directive a non-compliance with the SCR starts when the SCR ratio is below 100%. However supervisory actions may and should indeed start before, at least when a risk of breaching the SCR in the next 3 months is observed, according to the same article.

2.6. 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<sup>5</sup>. 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.

### **3. Content of the supervisory statement**

#### Observation of non-compliance

- 3.1. To comply with Article 138(1) of Solvency II , i.e. immediate information to supervisory authority as soon as observation of SCR not being complied with, 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 and communicated to the administrative, management or supervisory body (AMSB) immediately through their on-going monitoring.<sup>6</sup> Accordingly, supervisory authorities should consider as the start of the two-month 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.
- 3.2. 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>7</sup>

#### Request of a recovery plan under Article 138(2) of Solvency II

- 3.3. 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.
- 3.4. 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,

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<sup>5</sup> The cases of exceptional adverse situation and the extension of recovery period under Article 138(4) of Solvency II are out of the scope of this Supervisory Statement.

<sup>6</sup> A proper governance requires that insurance and reinsurance undertakings have to set up appropriate processes to ensure (i) that indications of (a) non-compliance with the SCR and/or (b) the risk of such non-compliance are investigated immediately and (ii) that the indications and the result of the investigation are communicated immediately to the AMSB and from there, if required, to the supervisory authority.

<sup>7</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.

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.

### Causes of non-compliance

- 3.5. In view of assessing the measures proposed in the recovery plan to restore the non-compliance situation, supervisory authorities should request from insurance and reinsurance undertakings, as part of the recovery plan or otherwise, an analysis of the key aspects of the causes of non-compliance and of any material 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.
- 3.6. If the causes of the breach of the SCR have impacted 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.

### Assumptions and scenarios of the recovery plan

- 3.7. When preparing their recovery plan in accordance with Article 142 of Solvency II, insurance and reinsurance undertakings should take into account the level of non-compliance with the SCR and the possible duration of the deterioration of the undertaking's financial conditions, and in particular the following non-exhaustive list considering the principle of proportionality:
- 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;
  - b) the assumptions should be tested for the different business lines, involving the relevant key functions, and where applicable and appropriate the parent company, subsidiaries and branches;
  - c) the scenarios should consider the 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) the expected future profits should be reassessed based on the revised plan for the next business period(s).

3.8. Considering that this Supervisory Statement is being published during a pandemic situation, EIOPA recommends that when preparing recovery plans in the context of the Covid-19 pandemic, undertakings should take the following specific points into account in addition to paragraph 3.7., also 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) 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) any probable mass downgrades of credit ratings and (iv) any possible positive correlation of some asset classes under the current environment;
- b) the economic scenarios should consider how the Covid-19 pandemic might evolve including possible further waves or similar events;
- 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 any possible decrements and policyholder behaviour including lapses, cancellations, increasing claims and potential litigation over compensation disputes, depending on the risk exposures.

3.9. 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.

3.10. 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.

3.11. 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.

## Recovery measures

- 3.12. Insurance and reinsurance undertakings should detail the realistic and timely recovery measures to restore their solvency position and keep such recovery sustainable, 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 paragraph 3.5. should be detailed.
- 3.13. 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.
- 3.14. 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.
- 3.15. 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.
- 3.16. Supervisory authorities should further consider contagion effects, including cross-sectoral and possible procyclical effects.

### Recovery period

- 3.17. 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.
- 3.18. 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>8</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.
- 3.19. 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. In case of cross-border business, the home supervisory authority should inform the host supervisory authorities of the decision made.

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<sup>8</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.

## Monitoring and non-compliance at the end of the recovery period

- 3.20. 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.
- 3.21. 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. These 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.
- 3.22. 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 all policyholders (including from home and the host countries in case of cross-border business) 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 and inform the host supervisory authorities accordingly.<sup>9</sup>

Done at Frankfurt am Main, on DayMonthYear.

[signed]

*For the Board of Supervisors*

[name]

Chairperson

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<sup>9</sup> This Supervisory Statement assumes that the insurance or reinsurance undertaking complies with the Minimum Capital Requirement.

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