



EIOPA-CP-14/046

27 November 2014

Consultation Paper
on
the draft proposal for
Guidelines
on the
extension of the recovery period in
exceptional adverse situations

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Responding to this paper

EIOPA welcomes comments on the draft proposal for Guidelines on the extension of the recovery period in exceptional adverse situations.

Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email Consultation_Set2@eiopa.europa.eu, by 2 March 2015.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents¹.

Contributions will be made available at the end of the public consultation period.

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading 'Legal notice'.

¹ [https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-\(EIOPA-MB-11-051\).pdf](https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-(EIOPA-MB-11-051).pdf)

Consultation Paper Overview & Next Steps

EIOPA carries out consultations in the case of Guidelines and Recommendations in accordance to Article 16 (2) of the EIOPA Regulation.

This Consultation Paper presents the draft Guidelines and the explanatory text.

The analysis of the expected impact from the proposed policy is covered under Annex I Impact Assessment.

Next steps

EIOPA will consider the feedback received and expects to publish a Final Report on the consultation and to submit the Consultation Paper for adoption by the Board of Supervisors.

1. Guidelines on the extension of the recovery period in exceptional adverse situation

Introduction

- 1.1. According to Article 138(4) of Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (hereinafter Solvency II)², supervisory authorities may, under certain circumstances, extend the recovery period for the re-establishment of compliance with the Solvency Capital Requirement (hereinafter "SCR") as set out in Article 138(2) of Solvency II by a maximum period of 7 years. This power applies in the event of exceptional adverse situations affecting insurance and reinsurance undertakings – collectively undertakings - representing a significant share of the market or affected lines of business, where undertakings fail to fulfil their SCR. It is vested in supervisory authorities in order to enable them to mitigate undue potential pro-cyclical effects of the financial system or adverse effects on the financial markets or in particular the insurance market that would ultimately be detrimental to the interests of policyholders and beneficiaries.
- 1.2. In order to ensure fair competitive conditions in situations where an extension of the recovery period is a possibility according to Article 138(4) of Solvency II, it is of outmost importance that supervisory authorities develop convergent practices from the entry into force of Solvency II when deciding to whom an extension should be granted and the duration of the extension. According to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (hereinafter "EIOPA Regulation")³, EIOPA therefore issues these Guidelines.
- 1.3. These Guidelines are addressed to the supervisory authorities to ensure that supervisory authorities use a consistent approach to the extension of the recovery period during exceptional adverse situations. These Guidelines also address further issues that call for convergent supervisory practices or enhanced harmonisation. These include the withdrawal/revocation of an extension, further extensions of extensions already granted, the exchange of information between supervisory authorities and the disclosure of withdrawals of extensions.
- 1.4. When EIOPA declares an exceptional adverse situation to exist according to Article 138(4) of Solvency II this does not automatically mean that every undertaking from a Member State to which this declaration applies is potentially eligible for an extension of the recovery period.

² OJ L 335, 17.12.2009, p. 1-155.

³ OJ L 331, 15.12.2010, p. 48-83.

- 1.5. Of the three exceptional adverse situations named in the second subparagraph of Article 138(4) of Solvency II, only a fall in financial markets that is unforeseen, sharp and steep will presumably have a major negative impact on every undertaking as this creates an unfavourable business environment. A persistent low interest rate environment is expected to mainly affect life insurance undertakings, life insurance activities of reinsurance undertakings and some lines of business of non-life insurance undertakings. A high impact catastrophic event may only affect some undertakings to a considerable extent as it will mostly affect certain lines of business.
- 1.6. There are important differences between the three named exceptional adverse situations with regard to the ability of undertakings to guard against such situations, preventing undertakings from breaching their SCR or recovering from such a breach of the SCR within the required timeframe. These differences need to be taken into account by the supervisory authority when deciding on whether an undertaking is eligible for an extension and on the duration of the extension.
- 1.7. The power to extend the recovery period is provided for no other reason than to create flexibility with regard to supervisory measures where a significant part of the insurance market faces major problems that could lead to serious repercussions for the market as a whole. These could develop if all players concerned were forced to take similar measures within the same limited time frame thus creating pro-cyclical effects on the financial system or where important elements of the insurance market are in financial difficulties with detrimental effects on the market.
- 1.8. In deciding on the duration of the extension of the recovery period, supervisory authorities are expected to keep in mind the exceptional character of an extension of the recovery period and the general rule of Article 138(3) of Solvency II which prescribes that undertakings need to ensure that they put in place the necessary measures to comply with the capital requirements within a limited timeframe of 6 to 9 months.
- 1.9. When the exceptional adverse situation is an unforeseen, sharp and steep fall in financial markets or a persistent low interest rate environment, decisions on the time period for extensions of the recovery period will require supervisory authorities to make assumptions about developments in financial markets. Where those assumptions are shown over time to have been significantly overoptimistic or pessimistic, supervisory authorities need to be able to correct their decisions by either further extending a given extension where expected improvements to the exceptional adverse situation have not materialised or by revoking the extension where obstacles to a quicker recovery have disappeared.
- 1.10. The Guidelines 1 to 13 apply to individual undertakings and *mutatis mutandis* to groups, i.e. when these Guidelines are applied to groups “undertaking” is to be

read as “group” and “supervisory authority” is to be read as “group supervisor”. Guidelines 14 to 15 apply only to groups and undertakings within groups.

1.11. For the purpose of these Guidelines, the following definitions have been developed:

(a) “extension of the recovery period” refers to a period granted for remedying a breach of the SCR that exceeds the time frame provided for in Article 138(3) of Solvency II;

(b) “withdrawing an extension” means when a supervisory authority taking back an extension where the undertaking concerned has failed to demonstrate significant progress towards remedying the breach of the SCR in accordance with subparagraph five of Article 138(4) of Solvency II;

(c) “revoking an extension” means when a supervisory authority taking back an extension on account of a material change in the exceptional adverse situation which repeals the basis for the extension.

1.12. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.

1.13. The Guidelines shall apply from 01 January 2016.

Guideline 1 – General considerations with regard to the granting of an extension

1.14. The supervisory authority should aim to prevent disproportionate negative effects for the financial market in general or the insurance market in particular when granting an extension of the recovery period and deciding on the duration of the extension. It should ensure that macro-prudential considerations are appropriately balanced against the need not to unduly jeopardise the protection of the policyholders and beneficiaries of the undertaking concerned.

Guideline 2 - Deciding on the duration of the extension

1.15. The supervisory authority should aim to be restrictive when deciding on the duration of the extension. Therefore, it should rather further extend the extension at a later date than grant a very long extension from the start, revoking it later when the exceptional adverse situation has improved significantly.

Guideline 3 – Granting of an extension to an existing recovery period if an exceptional adverse situation is declared to exist

1.16. If an exceptional adverse situation is declared by EIOPA, the supervisory authority should allow an undertaking to apply for a further extension of the recovery period before the end of a recovery period already granted in accordance with Article 138(3) of Solvency II.

Guideline 4 – Extension of the recovery period

- 1.17. The supervisory authority should require the undertaking to provide all relevant information to assist the supervisory authority in assessing the factors and criteria defined in Articles 279 c) to h) and 280 of the Implementing Measures. The recovery plan required by Article 138(2) of Solvency II following the observation of non-compliance with the SCR should include at least:
- (a) a justification of the extension and the proposed duration of the extended recovery period needed in order to address the exceptional adverse situation;
 - (b) a description of the measures the undertaking will take to achieve, within the proposed extension of the recovery period, the re-establishment of the level of eligible own funds covering the SCR or the reduction of its risk profile to ensure compliance with the SCR;
 - (c) the objectives to be achieved every three months as a result of the proposed measures and their expected effect on the solvency position;
 - (d) the projected SCR and projected level of eligible own funds at the end of the recovery period.

Guideline 5 - Extension on account of a fall in financial markets which is unforeseen, sharp and steep

- 1.18. Where EIOPA has declared a fall in financial markets which is unforeseen, sharp and steep to exist, the supervisory authority, in deciding on the extension of the recovery period and its duration, should pay particular attention to possible pro-cyclical effects that could materialise in view of the specific remedial measures the individual undertaking concerned would have to take in order to resolve the breach of its SCR within the timeframe allowed for the recovery by Article 138(2) of Solvency II.

Guideline 6 – Extension on account of a persistent low interest rate environment

- 1.19. Where EIOPA has declared a persistent low interest rate environment to exist, the supervisory authority, in deciding on the extension and determining its duration, should also pay specific attention to what measures were taken by the undertaking to limit the deterioration of its solvency position.

Guideline 7 – Extension on account of a high impact catastrophic event

- 1.20. Where EIOPA has declared a high impact catastrophic event to have taken place, the supervisory authority should consider an undertaking eligible for an extension of the recovery period, if the undertaking faces claims significantly higher than could have been expected under normal circumstances in the lines of business affected and the financial impact is not absorbed by recoveries from reinsurance contracts or other risk mitigation instruments.

Guideline 8 – No extension without the provision that the extension may be reduced or revoked

1.21. The supervisory authority should make all decisions to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period, as appropriate, where the situation which has led to the extension being granted has improved materially. In such a case the supervisory authority should review any extension granted that has not yet run out.

Guideline 9 – Applying a further extension of the recovery period where original assumptions have changed materially

1.22. The supervisory authority should allow an undertaking to request a further extension of the recovery period as long as the resulting overall extended recovery period does not exceed the maximum period of 7 years.

1.23. The supervisory authority should only consider a request for a further extension where the assumptions underlying the original recovery plan have changed materially and the request is supported by an adapted realistic recovery plan.

Guideline 10 – Exchange of information concerning extensions granted during an exceptional adverse situation

1.24. Where EIOPA determines that an exceptional adverse situation has occurred which affects more than one Member State, supervisory authorities in the Member States concerned should report to EIOPA and exchange information on the extensions granted and the duration, and the justification for these extensions in a timely manner.

Guideline 11 – Assessing significant progress

1.25. When assessing whether the undertaking has made significant progress towards compliance with its SCR, the supervisory authority should determine whether the undertaking is still likely to meet its recovery plan. The supervisory authority should consider at least whether the undertaking:

- (a) failed without sufficient justification to implement any measures it has committed itself to take; or
- (b) failed in making significant progress on any of the quantitative three-months' targets that were included in the recovery plan.

Guideline 12 - Withdrawal of the extension of the recovery period

1.26. If the supervisory authority concludes that the extension of the recovery period should be withdrawn, it should give the undertaking the opportunity to give its view on the proposed withdrawal within an appropriate timeframe.

Guideline 13 – Public disclosure of the withdrawal or revocation of an extension of the recovery period

- 1.27. Where the supervisory authority withdraws or revokes an extension of the recovery period, it should ensure that the undertaking complies without any delay with the requirement to publicly disclose such information, and the reasons for the withdrawal or revocation, in an update of its Solvency and Financial Condition Report.

Guideline 14 – Extension of recovery period for a group and for undertakings in the group

- 1.28. Where a group and one or more undertakings of the group are subject to the situations referred to in Article 138(1) to (4) of Solvency II at the same time, the group supervisor and the other supervisory authorities concerned should, where possible, ensure that the decisions that are taken at individual level and at group level concerning the possible extension of the recovery period and the recovery plans are consistent.

Guideline 15 – Decision of an extension of recovery period concerning an undertaking in a group

- 1.29. The college of supervisors should discuss any major decision concerning the extension of the recovery period for a subsidiary or the group itself, where the decision is of importance for the supervisory tasks of other supervisory authorities and before that decision is taken. The group supervisor should ensure that the discussions are held according to a schedule that does not impair the possibility for the subsidiary concerned and the group to restore its solvency in timely manner. The supervisory authorities having authorised the subsidiaries concerned should provide the group supervisor with the necessary information in a timely manner.

Compliance and Reporting Rules

- 1.30. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, competent authorities and financial institutions shall make every effort to comply with guidelines and recommendations.
- 1.31. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.32. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
- 1.33. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final Provision on Reviews

1.34. The present Guidelines shall be subject to a review by EIOPA.

2. Explanatory text

[Note: The aim of an explanatory text is to give further details or concrete applications or examples. Please note that the explanatory text will be included in the consultation paper only and **not in the final Guidelines**.

Considering that the guideline should be clear and unambiguous, the scope for further explanation should be limited.

The examples aim at showing in practical terms the concrete implementation of the guidelines or provide reference to other tools and guidelines.

These examples should not introduce further ambiguity as to the content of the guideline.]

Guideline 1 – General considerations with regard to the granting of an extension

The supervisory authority should aim to prevent disproportionate negative effects for the financial market in general or the insurance market in particular when granting an extension of the recovery period and deciding on the duration of the extension. It should ensure that macro-prudential considerations are appropriately balanced against the need not to unduly jeopardise the protection of the policyholders and beneficiaries of the undertaking concerned.

- 2.1. The supervisory authority needs to ensure it satisfies the purpose of Article 138(4) of Solvency II. The power to grant an extension of the recovery period is vested in the supervisory authority in order to provide it with the necessary flexibility to take decisions it considers necessary to prevent or mitigate disproportionate negative effects for the stability of the financial systems or pro-cyclical consequences.
- 2.2. The supervisory authority needs to take into account undertaking-specific factors and criteria according to Article 289 of the Implementing Measures, but the primary objective in granting an extension is the reduction or avoidance of pro-cyclical effects.
- 2.3. The decision to apply an extension of the recovery period and its duration is at the discretion of the supervisory authority. Whether it is justified to apply an extension and the duration of any extension needs to be determined on a case-by-case basis having regard to all the relevant factors and criteria in Article 289 of the Implementing Measures. The supervisory authority needs to give proper consideration to whether an extension of the time to re-establish compliance with the SCR is an adequate measure, considering the solvency position of the undertaking and potential consequences of requiring short-term rectification.
- 2.4. In the case of groups, the group supervisor needs to take into account a wider perimeter of analysis for the macro-prudential considerations and needs also to

consider the national specific provisions undertaken for the protection of national policyholders and beneficiaries of the individual undertakings included in the group. This implies a dialogue (communication) between the group supervisor and the supervisory authorities concerned, in line with Guideline 15 (group part).

Guideline 2 - Deciding on the duration of the extension

The supervisory authority should aim to be restrictive when deciding on the duration of the extension. Therefore, it should rather further extend the extension at a later date than grant a very long extension from the start, revoking it later when the exceptional adverse situation has improved significantly.

- 2.5. In deciding on the appropriate timeframe of the extension of the recovery period for an undertaking, the supervisory authority needs to take into account how long it expects the exceptional adverse situation to last. But extension periods cannot be chosen with a view to allowing undertakings to “sit out” an exceptional adverse situation. Therefore, the expected duration of the exceptional adverse situation does not provide the minimum extension period.
- 2.6. Article 138(4) of Solvency II represents an exception to the general rule that a recovery from non-compliance with the SCR needs to be performed within a very limited time frame. As any non-compliance with the SCR puts the interests of policyholders and beneficiaries at risk, the supervisory authority is supposed to make use of the power to extend the recovery period as carefully as possible. The more the proposed extension of the recovery period deviates from the recovery period according to Article 138(3) of Solvency II the more justification is needed. The maximum possible period for extending the recovery period is no indicator as to what is an appropriate “average” extension. The supervisory authority also needs to be very careful in order to prevent the maximum period of 7 years from serving as an unconscious “anchor”, drawing it towards longer extensions.
- 2.7. In particular in case of a high impact catastrophic event taking place, the supervisory authority is expected to consider carefully whether a limited extension of the recovery period could be sufficient to avoid the negative effects of a number of undertakings implementing a recovery plan at about the same time. The external situation could be such that it could be possible to mitigate potential detrimental effects for the market sufficiently without resorting to a longer extension of the recovery period.
- 2.8. It is not the objective of an extension of the recovery period to extend that recovery period until normal conditions are expected to be re-established, nor to enable the undertaking - for economic reasons - to choose a solution that takes considerably longer to implement than other options. The supervisory authority is required to always bear in mind that the objective of such extension is the protection of policyholders and beneficiaries.

- 2.9. EIOPA is responsible for regular monitoring whether the “exceptional adverse situation” is still existent. When EIOPA has determined that the situation has recovered in such a manner that the exceptional adverse situation no longer exists, the supervisory authority is not entitled to grant any further extensions of the recovery period on account of Article 138 (4) of Solvency II. Existing extensions continue to have effect. A supervisory authority would be expected to be especially careful about granting an extension of the recovery period where it believes that a declaration that the exceptional adverse situation is over, is imminent.
- 2.10. The final decision of the supervisory authority will depend on its assessment of the particular external and undertaking-specific situation and the business of the particular undertaking. There can be no “formula” regarding how the supervisory authority concludes on the appropriate timeframe for any extension.
- 2.11. The closer to the minimum capital requirement the level of own funds has fallen, the more urgent the need for the undertaking to improve its solvency position and the shorter the possible extension of the recovery period. How fast the solvency position is deteriorating and how close the undertaking gets to insolvency also needs to be considered.
- 2.12. Where an undertaking, in the opinion of the supervisory authority, has ready access to new capital on financial markets, the duration of any extension of the recovery period applied could potentially be shorter.
- 2.13. The liquidity of the market may have an impact on the valuation of the undertaking’s assets. If an undertaking does not have a readily available source of funds to finance short-term commitments, it will need to address this in addition to the longer term solvency problem. This could potentially have a bearing on the supervisory authority’s decision on whether to grant an extension and the duration of the extension period.
- 2.14. An undertaking could close the gap between the SCR and the level of own funds by taking measures to reduce the SCR through financial mitigation instruments. How feasible that option is, depends not only on the availability of such instruments but also on the ability of the undertaking to manage, monitor and control the instruments. When this option is an available and adequate means, this could potentially mean that an extension of the recovery period is not necessary or that the duration of the extension would be reduced.
- 2.15. Own funds are categorised into different tiers. This tier system may restrict an undertaking’s ability to solve the situation quickly. While it may be easier to raise tier 3 capital than higher level capital, an undertaking may need additional tier 1 or 2 capital to comply with the SCR. This could also potentially have a bearing on the supervisor’s decision to allow a longer extension period.

- 2.16. The composition of the undertaking's assets needs to be considered, as the undertaking could have a large stake in assets that would affect the market adversely if they were to be sold.
- 2.17. The undertaking may also be exposed to risks via its assets. The effect on the liquidity of the markets of an exceptional adverse situation of a fall in financial markets which is unforeseen, sharp and steep on the undertaking's asset portfolio, is relevant in that it will affect how easily an undertaking may be able to dispose of assets. The undertaking may still be able to sell some assets in order to change its risk profile and thereby reduce its exposure to market risk. On the other hand the quality of the assets held could be below average or more concentrated, thus increasing the risk to the undertaking independently from temporary market fluctuations.
- 2.18. Where the exceptional adverse situation is an exceptional fall in financial markets or a persistent low interest rate environment, the supervisory authority needs to consider the nature and duration of the undertaking's liabilities from an asset and liability management point of view. It could be appropriate to give a longer extension period to an undertaking whose liabilities have a longer duration.
- 2.19. While some solutions may generally help to improve the solvency position of an undertaking, these solutions may not be appropriate in individual cases where the costs are disproportionate to the benefits. Where an undertaking is seriously limited in the options that it can take for remedial actions, this could lead the supervisory authority to consider applying a longer extension of the recovery period – within the boundaries of the maximum extension of the recovery period – than would otherwise be applied.
- 2.20. Where an undertaking is part of a group and other undertakings in the group are in a position to help an undertaking in financial difficulties this is a possible way out of the situation. Where such assistance is available for the undertaking this potentially reduces the need for an extension of the recovery period or a longer duration of that period.
- 2.21. Undertakings cannot expect to be granted an extension of the recovery period if they choose not to use reasonable measures available to them to improve their situation.

Guideline 3 – Granting of an extension to an existing recovery period if an exceptional adverse situation is declared to exist

If an exceptional adverse situation is declared by EIOPA, the supervisory authority should allow an undertaking to apply for a further extension of the recovery period before the end of a recovery period already granted in accordance with Article 138(3) of Solvency II.

- 2.22. If, after the supervisory authority has approved a recovery plan following the undertaking's breach of the SCR, EIOPA determines that an exceptional adverse situation is taking place, this could affect an undertaking's ability to re-establish compliance with its SCR. In such a situation the supervisory authority may grant an extension of the recovery period at the request of the undertaking concerned. This request would have to include an adapted recovery plan.

Guideline 4 – Extension of the recovery period

The supervisory authority should require the undertaking to provide all relevant information to assist the supervisory authority in assessing the factors and criteria defined in [Articles 279 c) to h) and 280 (ERP3 and ERP4) of the Implementing Measures]. The recovery plan required by Article 138(2) of Solvency II following the observation of non-compliance with the SCR should include at least:

- (a) a justification of the extension and the proposed duration of the extended recovery period needed in order to address the exceptional adverse situation;**
- (b) a description of the measures the undertaking will take to achieve, within the proposed extension of the recovery period, the re-establishment of the level of eligible own funds covering the SCR or the reduction of its risk profile to ensure compliance with the SCR;**
- (c) the objectives to be achieved every three months as a result of the proposed measures and their expected effect on the solvency position;**
- (d) the prospective SCR and projected level of eligible own funds at the end of the recovery period.**

- 2.23. It is not a precondition for granting the extension that the "exceptional adverse situation" is the only or main cause of an undertaking's non-compliance with the SCR. However, an undertaking nevertheless would have to demonstrate how the "exceptional adverse situation" significantly affects its ability to re-establish coverage of the SCR.
- 2.24. It is for the undertaking to propose suitable remedial actions and a realistic recovery plan, including the necessary extension of the recovery period. The supervisory authority needs to assess the recovery plan submitted by the undertaking and decide on its feasibility and appropriateness. The supervisory authority will comment on any concerns it has with regard to the draft recovery plan as well as on the proposed duration of the extension and indicate if the undertaking needs to make changes before the supervisory approval of the recovery plan can be obtained.
- 2.25. The supervisory authority will react to the proposed recovery plan as soon as possible. Since the duration of the extension has a major effect on the content of the recovery plan, the undertaking may have to revise the plan if the supervisory authority is not prepared to grant the duration of the extension period the undertaking asked for initially.

- 2.26. The objectives of the recovery plan are to outline the measures the undertaking proposes to take to meet its SCR and to project the SCR and the expected level of eligible own funds at the end of each three months' period. The recovery plan also has to cover the description of the proposed measures in sufficient detail to allow for an assessment of whether the expected effect of the measures is realistic.
- 2.27. As the undertaking does not have to meet the SCR as it stood at the moment of the breach but the prospective SCR at the end of the recovery period, the undertaking has to extrapolate the expected SCR. With regard to the SCR the undertaking therefore needs to provide the supervisory authority with:
- a) the prospective SCR;
 - b) information on how it arrived at the prospective SCR;
 - c) a demonstration that the assumptions for the estimate are reasonable and sufficiently prudent to ensure that by meeting the targeted SCR at the end of the recovery period it will no longer be in breach of the actual SCR at that time.
- 2.28. As with any recovery plan, the supervisory authority needs to be satisfied that the measures set out in the plan are likely to succeed and to achieve the effect of remedying the SCR breach before agreeing to it. This includes being satisfied that the undertaking has not underestimated the prospective SCR at the end of the recovery period.

Guideline 5 - Extension on account of a fall in financial markets which is unforeseen, sharp and steep

Where EIOPA has declared a fall in financial markets which is unforeseen, sharp and steep to exist, the supervisory authority, in deciding on the extension of the recovery period and its duration, should pay particular attention to possible pro-cyclical effects that could materialise in view of the specific remedial measures the individual undertaking concerned would have to take in order to resolve the breach of its SCR within the timeframe allowed for the recovery by Article 138(2) of Solvency II.

- 2.29. When the exceptional adverse situation that exists is a fall in financial markets, which is unforeseen, sharp and steep, possible pro-cyclical effects are the major concern and are the most important deciding factor concerning an extension and its duration. Such effects could be either triggered by the individual undertaking or by several undertakings facing financial difficulties at the same time. Where one undertaking by itself or as part of a cluster of undertakings in difficulties has little effect on the financial market through its remedial actions, an important criterion for granting a longer recovery period is missing.

Guideline 6 – Extension on account of a persistent low interest rate environment

Where EIOPA has declared a persistent low interest rate environment to exist, the supervisory authority, in deciding on the extension and determining its duration, should also pay specific attention to what measures were taken by the undertaking to limit the deterioration of its solvency position.

2.30. A persistent low interest rate environment is by its nature not a sudden or unforeseen event. As the undertaking concerned could see the risk of such an event taking place a long way ahead, it is not appropriate that it benefits from a long extension of the recovery period if it seriously failed to take reasonably available measures to protect its solvency position against the impact of a long term low interest rate level. This in particular applies where the supervisory authority has already tried to get the undertaking to take appropriate steps.

Guideline 7 – Extension on account of a high impact catastrophic event

Where EIOPA has declared a high impact catastrophic event to have taken place, the supervisory authority should consider an undertaking eligible for an extension of the recovery period, if the undertaking faces claims significantly higher than could have been expected under normal circumstances in the lines of business affected and the financial impact is not absorbed by recoveries from reinsurance contracts or other risk mitigation instruments.

2.31. High impact catastrophic events, while likely to have some effect for a large number of undertakings, do not necessarily hit all these undertakings to a degree that justifies an extension of the recovery period where they fail to comply with the SCR at that time. Undertakings that cannot meet the SCR in a situation when EIOPA has declared a high impact catastrophic event to have taken place are only eligible for an extension of the recovery period if they are directly and severely affected by that event.

Guideline 8 – No extension without the provision that the extension may be reduced or revoked

The supervisory authority should make all decisions to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period, as appropriate, where the situation which has led to the extension being granted has improved materially. In such a case the supervisory authority should review any extension granted that has not yet run out.

2.32. How the supervisory authority ensures that it is able to revoke or reduce the extension of the recovery period depends on the legal framework of the

relevant Member State. It may have to point out that the extension may be revoked or reduced under certain circumstances when it grants the extension.

- 2.33. Although the supervisory authority is expected to consider carefully the duration of any extension of the recovery period it grants, in particular in the case of an unforeseen, sharp and steep fall in financial markets, it may turn out that the situation improves in such a way that an undertaking concerned could take faster actions to re-establish compliance with the SCR without significant detrimental effects for the market. If that is the case there would no longer be a justification for putting the interests of policyholders and beneficiaries at risk by maintaining inadequate own funds levels. Hence, the supervisory authority is expected to require the undertaking concerned to re-establish compliance with the SCR as soon as practicable.
- 2.34. A material improvement has taken place in particular where EIOPA has declared the relevant exceptional adverse situation to no longer exist.
- 2.35. Where the material improvement of the situation is not undertaking-specific, the supervisory authority is expected to ensure equal treatment of the undertakings still benefitting from an extension of the recovery period and also equal treatment of those undertakings and to undertakings that are subject to the normal recovery period. This is achieved by reviewing any existing extensions and reducing or revoking these as appropriate.
- 2.36. It may be expected that undertakings will rely on the extension period granted even where they are notified upfront that the extended period may be reduced under certain circumstances later on. So, even where the situation is fully back to normal and fast remedial actions are possible in general, the supervisory authority needs to consider what the realistic timeframe is for a recovery for the undertaking concerned under the changed circumstances.
- 2.37. Where the supervisory authority intends to revoke or reduce an extended recovery period it needs to provide the undertaking with the opportunity to provide its views before the final decision to reduce or revoke the extended recovery period is taken.

Guideline 9 – Applying a further extension of the recovery period where original assumptions have changed materially

The supervisory authority should allow an undertaking to request a further extension of the recovery period as long as the resulting overall extended recovery period does not exceed the maximum period of 7 years.

The supervisory authority should only consider a request for a further extension where the assumptions underlying the original recovery plan have changed materially and the request is supported by an adapted realistic recovery plan.

- 2.38. Article 138(5) of Solvency II 2009/138/EC, obliges national supervisory authorities withdraw the extension if an undertaking fails to show significant progress towards compliance with the SCR. However, in a persistent low interest rate environment or in a fall in financial markets which is unforeseen, sharp and steep the actual progress achieved does not solely depend on the undertaking concerned. Assumptions about developments could turn out to be vastly incorrect and after the approval of a recovery plan the situation could change so much that the supervisory authority agrees that on account of current developments the recovery plan can no longer be considered to be realistic. This is why an extension can be further extended.
- 2.39. A further extension of an initially extended recovery period is considered to be preferable to revoking an extension that with hindsight is recognised as overly long.
- 2.40. A request for a further extension of an initially extended recovery period requires the undertaking to submit an adapted realistic recovery plan within two months of discovering and notifying the supervisory authority that the current plan is no longer feasible on the basis of the extension the supervisory authority was previously prepared to grant. This is based on the mutatis mutandis application of the timeframe allowed for the submission of a realistic recovery plan according to Article 138(2).

Guideline 10 – Exchange of information concerning extensions granted during an exceptional adverse situation

Where EIOPA determines that an exceptional adverse situation has occurred which affects more than one Member State, supervisory authorities in the Member States concerned should report to EIOPA and exchange information on the extensions granted and the duration, and the justification for these extensions in a timely manner.

- 2.41. Exchange of information between supervisory authorities during the application of the power to grant an extension of the recovery period will serve a twofold purpose: as experience is gathered and shared between supervisory authorities, harmonisation will be enhanced, leading to a more effective and suitable consistency between supervisory authorities' supervisory actions. Further, knowing the size and number of the undertakings affected in other Member States can also help a supervisory authority to better assess potential pro-cyclical and de-stabilising effects that could be triggered on financial markets if the recovery period were not extended. In a group context, information about extensions granted to group undertakings will be exchanged within the College as such extensions require consultation.

Guideline 11 – Assessing significant progress

When assessing whether the undertaking has made significant progress towards compliance with its SCR, the supervisory authority should determine whether the undertaking is still likely to meet its recovery plan. The supervisory authority should consider at least whether the undertaking:

- (a) failed without sufficient justification to implement any measures it has committed itself to take; or**
- (b) failed in making significant progress on any of the quantitative three-months' targets that were included in the recovery plan.**

- 2.42. Significant progress will not be judged in absolute terms but individually against the undertaking's own recovery plan. This needs to include well defined and realistic interim milestones (measures to be taken for the re-establishment of the eligible own funds or the reduction of the risk profile) and timelines, according to which progress can be assessed.
- 2.43. A quarterly milestone does not necessarily have to show a quantifiable improvement of eligible own funds or reduction of the risk profile as it may take some time until measures to be taken show a positive effect. However in general, re-compliance with the SCR is expected to be commensurate with the amount of time of the recovery period that has already elapsed. This instance has to be taken into account in the drafting of the recovery.
- 2.44. Once a recovery plan is approved, an undertaking has to follow the plan and not deviate from it without consultation with the supervisory authority. Hence, the undertaking needs a good explanation for any failure to take the actions it has planned to take when submitting the recovery plan to the supervisory authority for approval. Not following the measures set out in the plan without demonstrating that there were very good reasons for not proceeding as planned will thus be considered as a significant lack of progress.
- 2.45. Where an undertaking does take the planned actions the results may fall behind the targeted results. This can still be considered to show significant progress as long as the deviation from the intended target is exceptional. Falling behind target could normally no longer be considered to be exceptional if it occurs two times in a row.
- 2.46. In a group context, information about significant progress, in particular on the SCR of the group undertakings concerned and the connected initiatives that have been undertaken (whether the undertaking is still likely to meet its recovery plan), needs to be exchanged within the College, also to inform the members of the college itself.

Guideline 12 - Withdrawal of the extension of the recovery period

If the supervisory authority concludes that the extension of the recovery period should be withdrawn, it should give the undertaking the opportunity to give its view on the proposed withdrawal within an appropriate timeframe.

- 2.47. As the withdrawal of an extension of the recovery period is a very serious supervisory measure, the undertaking concerned ought to be heard before any final decision to withdraw an extension is taken. In line with the basic idea that breaches of the SCR call for prompt measures, as evidenced by the short "normal" recovery periods and time limits for the submission of a recovery plan, undertakings however cannot expect an extensive period for comments.
- 2.48. When an extension is withdrawn, the undertaking is still in breach of the SCR but has run out of time to remedy the situation. In this case the supervisory authority has the power to take appropriate measures against the undertaking concerned. As when the normal recovery period has run out without full remedy of the SCR breach, these can be any measures necessary to close the gap between the SCR and the level of own funds as long as they are proportionate, i.e. no other adequate, less onerous measures are available.

Guideline 13 – Public disclosure of the withdrawal or revocation of an extension of the recovery period

Where the supervisory authority withdraws or revokes an extension of the recovery period, it should ensure that the undertaking complies without any delay with the requirement to publicly disclose such information, and the reasons for the withdrawal or revocation, in an update of its Solvency and Financial Condition Report.

- 2.49. The fact that a supervisory authority has withdrawn or revoked the extension of a recovery period which it originally agreed is a major development, significantly affecting the relevance of the information disclosed in the undertaking's Solvency and Financial Condition Report. As such the undertaking has to disclose the fact of the withdrawal or revocation and specify the reasons why it was considered not to have achieved significant progress towards remedying the breach of its SCR or why the supervisory authority has seen fit to cut the recovery period short. The supervisory authority needs to ensure that the information provided is appropriate and timely.

Guideline 14 – Extension of recovery period for a group and for undertakings in the group

Where a group and one or more undertakings of the group are subject to the situations referred to in Article 138(1) to (4) of Solvency II at the same time, the group supervisor and the other supervisory authorities concerned should, where possible, ensure that the decisions that are taken at individual level and at group level concerning the possible extension of the recovery period and the recovery plans are consistent.

- 2.50. In many cases it is expected that when the group is in a situation where it is subject to an extension of recovery period, then probably the same situation applies to at least one important insurance or reinsurance undertaking of the group. It seems then important that the decisions concerning the group and the undertakings of the groups are as consistent as possible, in the sense that they take into consideration the objectives, capabilities, resources (capital and financial), national legal framework of the group and the undertakings of the group concerned. In particular, it will be in many cases useful that the recovery plans are consistent and also that the recovery periods are the same.
- 2.51. Nevertheless, there will be also cases where consistency is less needed, in particular when a small undertaking which does not represent a material part of the group is also subject to an extension of recovery period.
- 2.52. In some cases it may be difficult or even undesirable to ensure consistency, because of different economic situation in particular Member States, on the basis of which the criteria mentioned in Article 138(4) of Solvency II can be fulfilled to a different extent in those Member States. For example, as regards a persistent low interest rate environment, differences in the level of interest rates between particular Member States, especially between Eurozone and non-Eurozone Member States, may lead to different decisions based on this criterion (because even if in both cases the interest rates are at a relatively or historically low level, the level may be different between particular member states and require for example that different extensions are decided). Also, as far as high-impact catastrophic events are concerned, those can influence the situation of (re)insurance undertakings in particular Member States and the situation of the group in a different manner or with a different severity. Additionally, pursuant to Guideline 10, national supervisory authorities will take into account the progress made to re-establish the level of eligible own funds covering the solo or group SCR or to reduce the risk profile to ensure compliance with the solo or group SCR. Since there can be significant differences in the progress made between particular (re)insurance undertakings in a group or between the level of the group and a single (re)insurance entity, the decisions on the extension of the recovery period can also significantly differ. Therefore, the efforts of college members will focus on aiming to ensure a consistent approach in the assessment of the fulfilment of the criteria, rather than ensuring that decisions taken are the same or similar.

Guideline 15 – Decision of an extension of recovery period concerning an undertaking in a group

The college of supervisors should discuss any major decision concerning the extension of the recovery period for a subsidiary or the group itself, where the decision is of importance for the supervisory tasks of other supervisory authorities and before that decision is taken. The group supervisor should ensure that the discussions are held according to a schedule that does not impair the possibility for the subsidiary concerned and the group to restore its solvency in timely manner. The supervisory authorities having authorized the subsidiaries concerned should provide the group supervisor with the necessary information in a timely manner.

- 2.53. The principles mentioned above apply also in the case of a group with centralized risk management, subject to the cases referred to in Article 138(1) to (4) of Solvency II both for the discussions concerning the recovery plan and the extension of the recovery period.
- 2.54. The discussions in the college will not be limited to the extension of recovery period itself but also include other major decisions like further extension, reduction, revocation and withdrawal of the recovery period and any material change concerning the recovery plan when the group is concerned or any subsidiary is of importance in the group.
- 2.55. On the other hand when the undertaking concerned represents a non-material part of the group, it may be considered sufficient that the supervisory authority gives information to the college, highlighting the fact that the impacts of the decision of an extension of the recovery period concerning the subsidiary are limited for the group itself.
- 2.56. The group supervisor that has been informed by the supervisory authority concerned needs to distribute necessary information also for the college (to the members of the college) in order to have sufficient elements for the discussion process.

Annex I: Impact Assessment

Section 1: Procedural Issues and Consultation of Interested Parties

- 3.1 According to Article 16 of the EIOPA Regulation, EIOPA conducts analysis of costs and benefits in the policy development process. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.
- 3.2 The Impact Assessment was prepared in the course of the policy drafting process, with the contribution of experts from different national competent authorities and EIOPA.
- 3.3 On the 29th of January 2010 EIOPA's predecessor CEIOPS provided advice to the European Commission for the draft Implementing Measures⁴. In particular the advice covered:
- The extension of the recovery period, including advice on a maximum period of 21 months for the extension of the recovery period, as referred to in article 138 (4) of the Solvency II Directive, in case of an exceptional fall in the financial markets;
 - And the factors to be taken into account by the supervisory authority when applying an extension of the recovery period beyond the recovery period as referred to in article 138 (3), first and second subparagraphs. This advice included an impact assessment as well.
- 3.4 In several instances the advice announced that further so-called Level 3 guidance would be contemplated in order to achieve further harmonisation between supervisory authorities beyond the subject matter of the advice⁵.
- 3.5 Directive 2014/51/EU⁶ amended Article 138 (4) Solvency II amended an extension of the recovery period may be applied in case of exceptional adverse situations affecting insurance and reinsurance undertakings representing significant share of the market or affected lines of business and the recovery period may be extended by a maximum period of 7 years.

⁴ CEIOPS-DOC-60/10.

⁵ See for instance paragraph 1.6: The Advice also touches upon how Article 138(4) is to be interpreted in CEIOPS' view and the questions that arise in the application of the article. It will, however, be left to Level 3 guidance to establish how the provision should be applied in practice in order to achieve a sufficient level of harmonisation, and paragraph 3.47: In order to make the withdrawal of an extension predictable, supervisors would however still have to establish what degree of fulfilment of the recovery plan's milestones is required for the progress to be taken as significant. CEIOPS proposes to settle this question in its Level 3 guidance.

⁶ DIRECTIVE 2014/51/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority)

- 3.6 The draft Guidelines and its Impact Assessment are subject to public consultation. Stakeholders' comments will serve as a valuable input in order to revise the Guidelines.

Section 2: Problem Definition

- 3.7 The provision in Solvency II that undertakings only have a comparatively limited period of time of six months (recovery period) to remedy the situation in case of a breach of the Solvency Capital Requirement (hereinafter SCR), with the power of the supervisory authority to extend that period, if appropriate, by three months, is new. Compared to the previous regime the additional provision, that in the event of exceptional adverse situations affecting insurance and reinsurance undertakings representing a significant share of the market or of the affected lines of business, the recovery period can be further extended by a maximum period of seven years, is also new. There is no previous or current supervisory experience with applying the power to extend the recovery period in exceptional adverse situations.
- 3.8 Solvency II is not specific about the relation between the named exceptional adverse situations, namely a fall in financial market which is unforeseen, sharp and steep, a persistent low interest rate environment or a high-impact catastrophic event, as referred to in article 138 (4), subparagraph 2, as amended by Directive 2014/51/EU, and the length of the extension of the recovery period, including the maximum period of seven years.
- 3.9 The Implementing Measures name the relevant factors and criteria for the purpose of deciding on an extension of the Recovery period and determining its length. However, the Implementing Measures are not explicit about the relation between certain factors and criteria and the decision to apply an extension of the recovery period and the appropriate timeframe for the extension of the recovery period or about the relative weighing of such factors and criteria in an individual case.
- 3.10 Without EIOPA Guidelines on the extension of the recovery period there would be considerable room for different interpretations as to whether to apply an extension of the recovery period and how to determine the appropriate duration of the extension of the recovery period. In the same manner, without issuing guidelines there would be uncertainty among supervisory authorities as to finding an appropriate balance, as regards supervisory actions and measures, such as whether or not to grant an extension of the recovery period and the duration of the recovery period, between the objective of achieving the protection of policy holders and beneficiaries on the one hand and considering the impact of such supervisory actions and measures on the stability of the financial system and preventing pro-cyclical effects of such supervisory measures and actions on the other hand.
- 3.11 An issue for undertakings might be a wish to know under which circumstances a withdrawal of the extension could take place after insufficient progress in the

execution of the recovery plan or a revocation of the decision to extend the recovery period could take place in case the circumstances that led to that decision have changed significantly.

- 3.12 There are good reasons to ensure that supervisory authorities from day one of the application of Solvency II have a common understanding about how their power under Article 138(4) will be applied, and what will be the requirements on undertakings in such a situation.

Proportionality

- 3.13 According to article 34 (6) of Solvency II supervisory powers shall be applied in a timely and proportionate manner. This also applies to the power to extend the recovery period. Recital 18 of Solvency II further explains the relevance of the proportionality principle as regard the application of supervisory powers by stating that "in order to ensure the effectiveness of the supervision all actions taken by the supervisory authorities should be proportionate to the nature, scale and complexity of the risks inherent in the business of an insurance or reinsurance undertaking, regardless of the importance of the undertaking concerned for the overall financial stability of the market." The factors and criteria to be taken into account, when deciding on a possible extension of the recovery period and the length of the extended recovery period, serve as a basis for supervisory authorities to apply the power to extend the recovery period in a proportionate manner.

Baseline

- 3.14 When analysing the impact from policies, the methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory or supervisory intervention.
- 3.15 The baseline is based on the current situation of EU insurance and reinsurance markets, taking account of the progress towards the implementation of the Solvency II framework achieved at this stage by insurance and reinsurance undertakings and supervisory authorities.
- 3.16 In particular the baseline will include:
- The content of Directive 2009/138/EC as amended by Directive 2014/51/EC.
 - The relevant Implementing Measures.

Section 3: Objective Pursued

- 3.17 The objective of the present guidelines is to provide a common understanding between supervisory authorities as to how the powers under Article 138(4) are to be applied, so promoting supervisory convergence (on methods, tools and powers) and cooperation and increasing transparency. Also, these guidelines should help supervisory authorities, when applying the power to extend the recovery period, to strike an appropriate balance between the main objective of supervision, according to article 27 of Solvency II, of the protection of policy holders and beneficiaries on the one hand, and - according to article 28 of Solvency II - the impact of their decisions on the stability of the financial system, including preventing potential pro-cyclical effects on the other hand.
- 3.18 Furthermore, such a common understanding would provide for making potential decisions of the supervisory authorities with regard to extension of the recovery period more predictable for the undertakings. Also, more clarity would be provided regarding the circumstances under which the supervisory authority will withdraw or revoke the decision to extend the recovery period or reduce the duration of the extended recovery period. That is important because the duration of the extended recovery period may have a significant impact on the financial situation of an undertaking.
- 3.19 The degree of predictability is however necessarily limited since the supervisory power to apply an extension of the recovery period and the decision on the appropriate duration of the recovery period depends on a number of factors and criteria that make it difficult to pre-determine which duration of the recovery period is the most appropriate in any given situation. The approach cannot be too prescriptive, but must leave supervisory authorities with the necessary flexibility.
- 3.20 A decision to extend the recovery period and more specific on the duration of the extended recovery period should also take into account that the duration of the extended recovery period should be:
- sufficiently long in order for the undertaking to be able to overcome the exceptional adverse situation affecting insurance and reinsurance undertakings representing a significant market share or affected lines of business, taking into account the stability of the financial markets and considering possible pro-cyclical effects,
 - no longer than necessary in order to serve the objective of protection of policy holders as far as possible.
- 3.21 Moreover, serving the protection of policy holders also means that, not being able to extend the recovery period or not applying such a power in case of exceptional adverse situations could have a detrimental effect on the insurance market as a whole and at the end of the day could seriously endanger the interests of policyholders and beneficiaries. However, where such

extraordinarily adverse situations on financial markets are not manifested anymore, the power to extend the recovery period should be withdrawn.

- 3.22 Therefore, the options and approaches have to be chosen with a view to properly cater for the needs of policyholders and beneficiaries in order to arrive at a way to apply the power vested in supervisory authorities that enhances their general protection.

Section 4: Policy Options

- 3.23 EIOPA has identified four issues that have been considered based on what EIOPA believes to be the most pressing themes for undertakings or supervisory authorities with regard to the application of the power to extend the recovery period. The options identified were also based on what issues could cause the most disruptive consequences to the level playing field if not appropriately addressed:

3.24 **Policy issue 1: Decision on the extension of the recovery period and its duration (Guidelines 1-7)**

Option 1.1: Provide no guidance on the decision on the extension of the recovery period and its duration;

Option 1.2: Provide guidelines, when deciding on the duration of the recovery period, on the application of the maximum period of seven years;

Option 1.3: Provide guidelines on a weighing of the factors and criteria to be taken into account when deciding on the extension of the recovery period and on the duration of the extension of the recovery period.

3.25 **Policy issue 2: Review of the decision to extend the Recovery period (further extension, reduction, revocation or withdrawal) (Guidelines 8,9,11 and 12)**

Option 2.1: Provide guidelines on making the decision to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period

Option 2.2: Provide guidelines specifying the milestones to be considered by the supervisory authority when deciding whether there has been significant progress in achieving the re-establishment of the Solvency Capital Requirement or a reduction of the risk profile.

3.26 **Policy issue3: Exchange of information between supervisory authorities (Guideline 10)**

Option 3.1: Provide guidelines on the exchange of information between supervisory authorities regarding decisions to extend the recovery period.

3.27 **Policy issue 4: Consistency of decision in case of extension of recovery period in a group (guideline 14)**

Option 4.1: Provide guidelines establishing a principle of consistency for decisions on the extension of the recovery period within a group.

Section 5: Analysis of Impact

3.28 In adopting Solvency II, policy-makers have already considered, analysed and compared a number of policy options. Based on the impact assessment done for the requirements set in Solvency II and in the Implementing Measures, EIOPA has considered the aforementioned options. In this section EIOPA discusses the options on which the impact assessment is focused.

3.29 Besides respecting the aforementioned principle of proportionality, the analysis was also closely linked to the principle of subsidiarity.

Policy issue 1: Decision on the extension of the recovery period and its duration (Guidelines 1-7)

- **Option 1.1: Provide no guidance on the decision on the extension of the recovery period and its duration.**

3.30 The power to extend the recovery period is new. Undertakings and supervisory authorities do not have experience with such a power. Both have to gain experience with applying this power, the more so where the possible duration of the extended recovery period ranges from 1 month to seven years. Providing guidance from the outset would possibly limit undertakings and supervisory authorities in gaining full experience with the application of these powers and would limit the possibilities of developing best practices from practical experience with a range of concrete situations. Not providing guidance on the decision on the extension of the recovery period and its duration would not limit the expectations of undertakings as regards any request to extend the recovery period and its duration in case an exceptional adverse situation has been declared. Such would leave as much as possible room for undertakings to justify any request, taking into account the specific circumstances at hand. Also, supervisory authorities would be able to apply the power to extend the recovery period, taking into account all relevant circumstances, without being restricted by any predetermined reasoning. Any supervisory decision to extend the recovery period could be as much as possible proportionate to the specific circumstances of the undertaking.

3.31 On the other hand, lacking any guidance on the application of the power to extend the recovery period and its duration could increase uncertainty of undertakings on how to apply for an extension of the recovery period and its duration. Supervisory authorities would need to develop complete new processes, each on their own. Such would impact on the efficiency and effectiveness of the process of requesting (undertakings) and decision making

(supervisory authorities) for an extension of the recovery period and its duration.

- **Option 1.2: Provide guidelines, when deciding on the duration of the recovery period, on the application of the maximum period of seven years.**

- 3.32 An extension of the recovery period with a maximum period of 7 years creates a recovery period of 93 (84+9) months, i.e. a recovery period that is more than 10 times as long as a normal (already extended) recovery period. A deviation from normal proceedings of that magnitude requires very strong arguments that are balanced against the risks such a long period of non-compliance with the SCR poses for policyholders and beneficiaries. This long period should be considered to be absolutely necessary in order to avoid or mitigate pro-cyclical effects or otherwise detrimental effects to the stability of the financial markets of supervisory measures or actions addressing such exceptional adverse situations affecting insurance and reinsurance undertakings representing significant share of the market or affected lines of business.
- 3.33 Undertakings may feel the impact from an exceptional adverse situation for quite some time but the purpose of an extension of the recovery period is not to cover the time until the situation is back to normal. However, in order to mitigate the impact of an exceptional adverse situation on a significant part of the insurance market of affected lines of business having to remedy solvency problems at roughly the same time, any extension of the recovery period does not have to be based on how long the exceptional adverse situation is expected to continue. It is only necessary to ensure that the impact of a number of undertakings taking remedial actions is spread over a sufficiently long time.
- 3.34 EIOPA considered whether, as regards the application of the maximum period of seven years for the recovery period, the Guidelines should differentiate between the exceptional adverse situations identified in Solvency II. From neither of these exceptional adverse situations it is from the outset clear how long such a situation in extreme circumstances might prolong. Differentiating between these exceptional adverse situations might therefore be considered disproportionate. On the other hand, a period of seven years is of such a duration that it is for all parties involved – undertakings, supervisory authorities – almost impossible to reasonably predict how the situation, as well as the impact on the ability to recover from non-compliance with the SCR because of the situation, will evolve over the full duration of the maximum period of seven years. Because of this uncertainty there is the risk that the initially granted extended recovery period may, at some point in time in the future, appear to be too long, as the situation that led to the decision to grant that extension of the recovery period and the duration of such recovery period has improved in such a manner that no or not such a long remaining extension of the recovery period will be justified at that point in time in the future. The supervisory authority may then feel the need to reduce or revoke the extension of the

recovery period. This risk could be avoided by not applying from the outset the maximum period of seven years when deciding on the duration of the recovery period.

3.35 Not providing guidance on how to decide on the duration of the extension of the recovery period, including the maximum period of seven years, might provoke unwarranted expectations by undertakings. Also, supervisory authorities may feel the need to consider and justify (where a decision to extend the recovery period may be brought to court) in any case a possible maximum period of seven years without taking into account the uncertainty about how the situation will evolve and the risk of having to reduce or revoke the initially granted extended recovery period.

- **Option 1.3: Provide guidelines for a weighing of the factors and criteria to be taken into account when deciding on the extension of the recovery period and on the duration of the extension of the recovery period.**

3.36 The Implementing Measures provide an exhaustive list of factors and criteria to be taken into account in deciding whether an extension of the recovery period should be applied and, where appropriate, in deciding on the duration for the extension. However, the Implementing Measures do not specify which factors and criteria could potentially matter more in favour or against a decision to extend the recovery period. Nor do they provide any steering to the supervisory authority as to how such factors and criteria should be weighed when deciding on the duration of the recovery period. EIOPA discussed the benefits of having more specific guidance in order to produce more comparable supervisory decisions.

3.37 Generally, undertakings would benefit from supervisory authorities applying a predetermined weighing of factors and criteria when deciding to extend the recovery period and on the duration of the recovery period. Such features and approaches would enhance predictability of supervisory decisions and would enhance level playing field between undertakings applying for an extension of the recovery period. On the other hand, an undertaking, when applying for an extension of the recovery period, is not supposed to take for granted a positive decision, neither a specific duration of the extended recovery period. On the contrary, the undertaking has to base its contingency plans for capital management on the assumption that the recovery period will not exceed the normal length of at the most nine months.

3.38 From the perspective of supervision it is in the interest of supervisory authorities to set clear criteria according to which a supervisory authority can extend the recovery period in the event of exceptional adverse situations affecting insurance and reinsurance undertakings representing a significant share of the market or affected lines of business. A prescribed weighing of factors and criteria would serve the efficiency and effectiveness of the decision making process.

- 3.39 From the perspective of policy holders and beneficiaries, limiting the degree of freedom of supervisory authorities when deciding on the extension of the recovery period and the duration of the recovery period, by 'prescribing' the weighing of such factors and criteria, would prevent the decision on the recovery period being potentially unbalanced as regards their interest of the undertaking recovering its SCR as soon as possible.
- 3.40 On the other hand, when the weighing of factors and criteria would have been predetermined from the outset, supervisory authorities would not be able to learn from experience from applying the power to extend the recovery period nor could they take into account another possible weighing of factors and criteria, emerging from such supervisory experience. The result would be that supervisory authorities being prevented from taking an otherwise appropriate decision to extend the recovery period could put undertakings in a disadvantageous situation. Such an approach would therefore unnecessarily tie the hands of supervisory authorities with the result that they would not be able to apply the power to extend the recovery period 'in a proportionate manner', as required by article 34 (6) of Solvency II. This could result in outcomes that would be at the detriment of undertakings and policy holders and beneficiaries.
- 3.41 Furthermore, a too strictly prescribed application of the power to extend the recovery period could potentially limit undertakings to pursue their businesses and policy holders to engage with such undertakings. Reducing the number and variety of undertakings offering products and services in the market may reduce the variety of insurance products offered, which could also have a negative impact on pricing. Such effects would be at the detriment of the interests of policy holders and beneficiaries. What is required is a proportionate application of these powers by supervisory authorities, for good reasons laid down as a leading principle when applying supervisory powers.

Policy issue 2: Review of the decision to extend the recovery period (further extension, reduction, revocation or withdrawal) (Guidelines 8,9,11 and 12)

- **Option 2.1: Provide guidelines on making the decision to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period.**
- 3.42 As regards the duration of the extension of the recovery period in case of an exceptional adverse situation Solvency II provides for a maximum extension period of seven years. Theoretically and practically, it would be impossible to predict that a declared exceptional adverse situation would prolong over the full period of seven years. Nor will it be possible to predict how long such an exceptional adverse situation would in fact prolong. This impacts the decision making on the appropriate duration of the extended recovery period.
- 3.43 In a given case, where an undertaking A has been granted an extension of the recovery period of x months, it could occur that before this period of x months has come to an end EIOPA declares the relevant exceptional adverse situation

no longer to exist or that the situation which has led to the extension of the recovery period being granted has improved materially. Any undertaking B that after this point in time would become in breach of the SCR would be granted a recovery period of 6 months, possibly extended to 9 months, or, where the exceptional adverse situation still exists but has improved materially, much shorter extended recovery periods would be granted. It could then occur that undertaking A would benefit from a longer (remaining) recovery period than the recovery period of undertaking B. This would imply an unlevelled playing field between undertakings. In order to prevent such a potential unlevelled playing field, supervisory authorities will be inclined to provide for rather limited (initial) recovery periods. However, where, at the close of such a limited recovery period it would still be justified for the undertaking to be granted a further extension of the recovery period, the undertaking needs to apply for a further extension of the recovery period and the supervisory authority would have to decide on such a further extension. Such would impose additional costs on undertakings and supervisory authorities.

- 3.44 The potential unlevelled playing field described in the previous paragraph could be prevented where the supervisory authority would have the power to reduce or revoke an initially granted extended recovery period at that point in time where EIOPA declares the relevant exceptional adverse situation no longer to exist or where the situation that has led to the application of the recovery period has improved materially. However, it is uncertain whether each supervisory authority within the legal regime of the Member State would have the power to reduce or revoke the initial decision to extend the recovery period. Moreover, even if supervisory authorities would have the power to reduce or revoke an initially granted extended recovery period, between Member States there could be differences as regards the possibility of undertakings to object to such a decision to reduce or revoke the extended recovery period or to appeal against such a decision. This would create uncertainties for undertakings and supervisory authorities and would trigger a further unlevelled playing field between undertakings.
- 3.45 In order to overcome the drawbacks and potential costs described in the previous paragraphs EIOPA has considered to introduce as much as possible legal certainty as regard the power to reduce or revoke an initially granted extended recovery period by providing for a guideline implying that supervisory authorities should make all decisions to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period as appropriate where the situation which has led to the extension of the recovery period has improved materially. Such a provision on the power to revoke or reduce the extended recovery period, including the circumstances in which such a power may be applied, will be an integral part of the initial decision to extend the recovery period, thereby increasing legal certainty about the application of this power.
- 3.46 Where supervisory authorities include such a provision in the decision to extend the recovery period, they will be more comfortable about applying a realistic

duration of the extension of the recovery period, taking into account the exceptional adverse situation at stake as well as the specific circumstances of the undertaking applying for an extension of the recovery period, thereby reducing the need for further extensions of the recovery period. And, where unforeseen, the duration of the recovery period would need to be reduced or revoked at some point in time in the future, the supervisory authority will have a secure power to do so. At such a future point in time the supervisory authority could then prevent an unlevelled playing field between undertakings that have been granted with an extended recovered period on the one hand and other undertakings in breach of the SCR by that time that need to comply with the normal recovery period of 6 or possibly 9 months on the other hand.

- **Option 2.2: Provide guidelines specifying the milestones to be considered by the supervisory authority, when deciding whether there has been significant progress in achieving the re-establishment of the Solvency Capital Requirement or a required reduction of the risk profile.**

- 3.47 EIOPA discussed the precise milestones that an undertaking would have to reach in order for the supervisory authority to determine that the progress towards re-compliance with the SCR is to be considered significant as requested by article 138 (4), third subparagraph of Solvency II. If no such progress has been achieved, according to article 138(4), fourth subparagraph of Solvency II, the supervisory authority is required to withdraw its decision to extend the recovery period. Specifying such milestones would provide for transparency and would ensure a fair and equal treatment for all undertakings to which an extension of the recovery period has been applied and would provide clarity to stakeholders, and more specifically to policy holders and beneficiaries, up to which point any further extension of the recovery period would not be considered justified.
- 3.48 Detailing the milestones to be achieved and putting quantitative thresholds on the achievements of such milestones would benefit undertakings and stakeholders, including policyholders and beneficiaries, when supervisory authorities assess progress of re-establishment of the SCR, especially where not showing the required progress would force supervisory authorities to withdraw the extension of the recovery period. And, as the decision to withdraw the extension of the recovery period may have a considerable potential impact on the undertaking, it is of interest of the supervisory authority to apply as clear and unambiguous criteria determining the progress to be achieved in re-establishing the SCR as possible.
- 3.49 EIOPA considered that the withdrawal of an extension of the recovery period because the undertaking failed to demonstrate significant progress towards the aim of re-establishing the SCR has considerable consequences for the undertaking concerned, in particular since this supervisory measure has to be publicly disclosed. As a withdrawal of the extension of the recovery period is mandatory when progress is not significant, this is also an important issue for the supervisory authority. Guidelines that would specify when progress is not

significant would inform undertakings and enable them to assess whether they are in danger of losing an extension. They could take this into account in their efforts to re-establish compliance with the SCR and this could help avoid situations where the supervisory authority is obliged to withdraw the extension as undertakings could be expected to do their utmost to reach the milestone of significant progress.

- 3.50 However, it has also been considered that very specific milestones, such as exact percentages, could produce the opposite effect for some undertakings as they could try to meet the thresholds rather than the full milestones. Therefore, prescribing such milestones and thresholds in detail could prevent supervisory authorities from applying this power in a proportionate manner. Moreover, having in place sufficiently precise milestones could also be provided for by the recovery plan to be submitted by the undertaking to the supervisory authority and to be approved by the supervisory authority.
- 3.51 Guidelines specifying milestones could also help to ensure fair and equal treatment for all undertakings to whom an extension has been applied. In view of the consequences of a withdrawal of an extension of the recovery period for an undertaking, it is particularly important that the same measure should be applied to all undertakings so nobody is put at a disadvantage.
- 3.52 On the downside, being very prescriptive provides no flexibility to supervisory authorities not to withdraw the extension where an undertaking fails to meet the milestones, when this failure is due to factors and criteria over which it has no control. While it is easy in theory to set milestones they may well turn out not to meet the purpose and fail to cover just those cases for which a withdrawal of the extension would be an appropriate reaction.

Policy issue 3: Exchange of information between supervisory authorities (Guidance 10)

- **Option 3.1: Provide guidelines on the exchange of information between supervisory authorities regarding decisions to extend the recovery period.**

- 3.53 According to article 31 of Solvency II and the Implementing Measures supervisory authorities have to disclose aggregated statistical data on the number of extensions granted in accordance with Article 138(4) Solvency II and their average duration. Supervisory authorities also have to share such information about individual undertakings when cross-border groups or undertakings with (significant) business in other Member States are concerned.
- 3.54 Where exchange of information between supervisory authorities on the application of the power to extend the recovery period and on the duration of the recovery period would inform and thereby support proper supervisory decision making, undertakings would benefit from such information exchange between supervisory authorities, also because this would improve the level

playing field. Policy holders and beneficiaries may benefit from such an improved level playing field where they are treated more equally across Europe.

- 3.55 EIOPA discussed whether, and under what conditions, an exchange of information in the event of the application of article 138 (4) of Solvency II should take place. This could ensure a more harmonised approach to applying the power to extend the recovery period. Supervisory authorities could compare the circumstances where an extension was already applied with the particular request at stake. Having some knowledge and experience about practices developing across the EU would clearly facilitate the tasks of the supervisory authority. Justifying how their specific case is comparable or significantly different from closed cases is easier for a supervisory authority than developing a framework of reference on its own.
- 3.56 An exchange of information could also give more assurance to supervisory authorities, undertakings and policy holders and beneficiaries that the undertakings on the national market are not treated either more leniently or more strictly than undertakings across the EU and that the supervisory decisions contribute to keeping the level playing field.
- 3.57 However, describing cases in such way that the specificities of the individual situation of undertakings are really comparable may be easier in theory than in practice. It could make it more difficult for supervisory authorities to deviate from what they consider an inappropriate decision as the implicit assumption is that all decisions already taken are "good". This could be avoided by using the exchange of information for information purposes only and not implying a preferred solution. A further issue in practice could be that this exchange of information could require quite a lot of effort. The factors and criteria for applying for an extension and for deciding on the specific duration would have to be set out very clearly, at a time when supervisory authorities are involved with dealing with the problems arising from the exceptional adverse situations affecting insurance and reinsurance undertakings representing significant share of the market of affected lines of business.
- 3.58 If an exchange of information was required, it would help if the process for doing so was clearly set out in order to ensure that all relevant information reaches the other supervisory authorities in a timely manner and in sufficient detail. It may however not be necessary to design a specific process just for the exchange of information about the extension of the recovery period. Supervisory authorities are already required to exchange important or relevant information without delay. They could use the same processes and procedures for the exchange of information about extensions of the recovery period.

Policy issue 4: Consistency of decision in case of extension of recovery period in a group (guideline 14)

- **Option 4.1: Provide guidelines establishing a principle of consistency for decisions on the extension of the recovery period within a group.**

- 3.59 According to article 218 of Solvency II, article 138 (1) to (4) applies to groups *mutatis mutandis*. There may be cases where both the group and undertakings within the group are at the same time in breach of the SCR and whereby an exceptional adverse situation as declared by EIOPA is applicable. Then both the group and the relevant undertakings may apply for an extension of the recovery period. According to paragraph 5 of article 218 of Solvency II, any non-compliance of the group with the SCR will be analysed by the college of supervisors. According to article 248, paragraph 2, second subparagraph, the college of supervisors shall ensure that cooperation, exchange of information and consultation processes among supervisory authorities are effectively applied. In this respect it may be expected that the group supervisor and supervisory authorities of the relevant undertaking in breach of the SCR will align as far and practically possible their decisions as regards the extension of the recovery period and the duration of the extended recovery period.
- 3.60 Where the power to extend the recovery period is new and undertakings and supervisory authorities need to gain experience with these powers, the more so this is this valid within a cross-border group context, including the responsibilities of the group supervisor and the college of supervisors. Learning from these experiences could trigger group supervisors and supervisory authorities to develop best practices that could eventually feed into EIOPA Guidelines. Providing from the outset detailed guidelines on the application of the power to extend the recovery period and its duration, including perfect consistent alignment of decision making within a group context, would limit the possibility for undertakings, group supervisors and supervisory authorities to gain such experiences and subsequently develop such best practices. Such detailed guidelines could also limit the opportunity to take account of the different circumstances at group and undertaking level and subsequently lead to disproportionate supervisory decisions.
- 3.61 On the other hand, without any guiding principle of consistency of decision making in a group context as regards the application of the power to extend the recovery period and its duration, groups, undertakings, group supervisors and supervisory authorities may experience uncertainties about the application of the power to extend the recovery period and on deciding on the (duration of) the recovery period. Such uncertainties may be at the detriment of supervisory decision making at group and undertaking level including alignment of such decision making. In the end this could also be at the detriment of justified interests of the group or undertakings within the group.
- 3.62 By providing for a principle based guideline it should be ensured that there is a discussion in the college of supervisors to ensure that the need for consistency is duly taken into account.

Section 6: Comparison of Options

Policy issue 1: Decision on the extension of the recovery period and its duration

3.63 In comparing the options against the objects pursued, i.e.:

- advancing supervisory convergence and cooperation and increasing transparency, and on a more operational level, harmonising supervisory methods, tools and powers,
- striking an appropriate balance between the main objective of supervision of the protection of policy holders and beneficiaries on the one hand and the impact of supervisory decisions on the stability of the financial markets, including preventing pro-cyclical effects, on the other hand,

3.64 EIOPA made the following assessments of the costs and benefits of the options considered.

Undertakings

3.65 Additional costs for undertakings can be evaluated to be of a much less compared to those introduced by Solvency II:

- The guidelines do not diminish the opportunity of undertakings of being entitled to apply for an extension of the recovery period and being granted the duration of the recovery period needed, taking into account the exceptional adverse situation at stake.
- Possible additional costs are minimised by informing expectations of undertakings about the request for an extension of the recovery period, the duration of the recovery period, the possibility of a reduction or revocation of the recovery period and what has to be achieved in order prevent an extension of the recovery period being withdrawn.
- The Guidelines diminish uncertainty about (lack of) convergent supervisory decisions across Europe as regards the application of the power to extend the recovery period.

3.66 In front of minor additional costs arising from these EIOPA Guidelines undertakings would gain benefits:

- The Guidelines provide for a risk-based and proportionate application of the power to extend the recovery period, taking into account the relevant factors and criteria according to the Implementing Measures;
- The Guidelines provide for clarity about the possibility to apply for a further extension of the recovery period within the overall maximum period of seven years;
- The Guidelines provide clarity about the supervisory expectations as regards the progress in re-establishing compliance of the SCR that needs to be achieved in order to prevent an extension of the recovery period being withdrawn.

Supervisory authorities

- 3.67 The Guidelines do not add additional costs, from the perspective of supervisory decision making and monitoring supervisory decisions, compared to the provisions of Solvency II and the Implementing Measures.
- 3.68 Also, the guidelines aim to prevent supervisory decisions being limited unnecessarily by too restrictive requirements as regards the weighing of factors or assessment of a significant progress to be achieved by undertakings with respect of the re-establishment of the SCR, thereby facilitating a proportionate application of the requirements.
- 3.69 On the other hand the guidelines provide supervisory authorities with guidance as regards the need at any stages of the supervisory decision making on the application of the power to extend the recovery period, to balance the interests of policy holders and beneficiaries on the one hand and preserving stability of the financial markets and considering the pro-cyclical impact of supervisory decisions on the other hand.
- 3.70 The Guidelines provide for clear expectations about sharing of information among supervisory authorities.

Policy holders

- 3.71 The Guidelines aim to limit additional costs of the power to extend the recovery period by aiming to prevent a too restrictive application of this power, where a too restrictive application could imply that an undertaking may be possibly unjustifiably obliged to sell no new policies or to withdraw from the market.
- 3.72 The Guidelines provide for clear guidance about the need to balance the interests of policy holders and beneficiaries on the one hand and preserving stability of the financial markets and considering the pro-cyclical impact of supervisory decisions on the other hand.
- 3.73 The Guidelines aim to provide for equal treatment of policy holders and beneficiaries across Europe as regards the impact of the application of the power to extend the recovery period on their interests.
- 3.74 Therefore, the preferred policy option for this policy issue is option 1.2: provide guidelines, when deciding on the duration of the recovery period, on the application of the maximum period of seven years. This option is preferable to option 1.1 (not providing guidance) to reach the objectives defined in section 3 of this report. It is also preferable to option 1.3 (weighing of the factors and criteria) since too prescriptive guidelines could unnecessarily limit the ability for supervisory authorities to apply their supervisory powers in a proportionate manner and that could be a disadvantage for the concerned undertakings.

Policy issue 2: Review of the decision to extend the recovery period (further extension, reduction, revocation or withdrawal)

3.75 The comparison of effects on the different stakeholders groups of the decision on the extension of the recovery period is applicable also to those decisions to be adopted by supervisory authorities concerning the recovery period already extended (further extension, reduction, revocation or withdrawal). Taking account of the effects on policy holders, supervisory authorities and policy holders, the preferred policy option for this policy issue is option 2.1: Provide guidelines on making the decision to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period. This option is preferable to option 2.2 (providing detailed milestones and thresholds), which was discarded since it could prevent supervisory authorities from applying this power in a proportionate manner and could be a disadvantage for the concerned undertakings.

Policy issue 3: Exchange of information between supervisory authorities.

3.76 For this policy issue, only one option was considered (option 3.1): provide guidelines on the exchange of information between supervisory authorities regarding decisions to extend the recovery period.

Policy issue 4: Consistency of decision in case of extension of recovery period in a group.

3.77 For this policy issue, the only option considered was providing guidance establishing the principle of consistency for decisions on the extension of the recovery period within a group (option 4.1). The option of providing very detailed guidelines was disregarded due to the undesirable lack of flexibility both for undertakings and supervisory authorities.