

Consultation Paper
on the Advice to the European
Commission
in response to the Call for Advice
on recovery plan, finance scheme and
supervisory powers in deteriorating
financial conditions

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Responding to this paper

EIOPA welcomes comments on the Consultation Paper on recovery plan, finance scheme and supervisory powers in deteriorating financial conditions.

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 18 February 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Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published.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 www.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 received a call for advice from the Commission on 24 July 2014 to provide technical advice to assist the Commission on the possible content of the delegated acts.

EIOPA has prepared this Consultation Paper which presents in detail EIOPA's Technical Advice to the Commission. Interested parties are invited to comment on these proposals.

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. Draft Technical Advice

Legal background

According to Article 138(2) 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") the insurance or reinsurance undertaking (hereinafter collectively "undertaking") concerned shall, within two months from the observation of non-compliance with the Solvency Capital Requirement (hereinafter "SCR") submit a realistic recovery plan for approval by the supervisory authority.

According to Article 139(2) of Solvency II the undertaking concerned shall, within one month from the observation of non-compliance with the Minimum Capital Requirement (hereinafter "MCR") submit, for approval by the supervisory authority, a short-term realistic finance scheme to restore, within three months of that observation, the eligible basic own funds, at least to the level of the MCR or to reduce its risk profile to ensure compliance with the MCR.

According to Article 141 of Solvency II the supervisory authorities shall have, within their supervisory powers in deteriorating financial conditions, the power to take all measures necessary to safeguard the interests of policyholders in the case of insurance contracts, or the obligations arising out of reinsurance contracts, where the solvency position of the undertaking continues to deteriorate. Those measures shall be proportionate and thus reflect the level and duration of the deterioration of the solvency position of the insurance or reinsurance undertaking concerned.

According to Article 142 of Solvency II the recovery plan and the finance scheme shall at least include particulars or evidence concerning the following:

- (a) estimates of management expenses, in particular current general expenses and commissions;
- (b) estimates of income and expenditure in respect of direct business, reinsurance acceptances and reinsurance cessions;
- (c) a forecast balance sheet;
- (d) estimates of the financial resources intended to cover the technical provisions and the solvency capital requirement and the minimum capital requirement;
- (e) the overall reinsurance policy.

According to Article 143(2) of Solvency II, in order to ensure consistent harmonisation in relation to Article 138(2), Article 139(2) and Article 141, EIOPA shall, subject to Article 301b, develop draft regulatory technical standards to specify the recovery plan referred to in Article 138(2), and the finance scheme referred to in Article 139(2) and with respect to Article 141, taking due care to avoid pro-cyclical effects. Power is delegated to the Commission to adopt these regulatory technical standards in accordance with Articles 10 to 14 of Regulation (EU) No 1094/2010. According to Article 301b (1) in connection with Article 301a of Solvency II, the Commission will adopt these regulatory technical standards as delegated acts.

Unless otherwise stated, references in this Technical Advice concern the relevant provisions of Solvency II.

The Commission's call for advice

EIOPA is requested to provide technical advice on the following issues:

- the recovery plan referred to in Article 138(2);
- the finance scheme referred to in Article 139(2);
- with respect to Article 141 (supervisory powers in deteriorating financial conditions).

Recovery plan and finance scheme

Analysis

EIOPA considers that it is necessary to specify the components of the recovery plan and finance scheme listed in Article 142(1), as well as to add further components, since the list in Article 142(1) does not cover some important information.

As far as the content is concerned, the requirements in Article 142 are applicable to both the recovery plan and the finance scheme. However, the content of the finance scheme will be determined by the urgency of the measures for the re-establishment of compliance with the MCR.

It is necessary that undertakings provide a prospective SCR/MCR for the end of the recovery period which is the target SCR/MCR for the re-establishment of compliance with these capital requirements. Information on the prospective SCR should be as granular as the information submitted by way of regular reporting.

Information on both the prospective SCR and the prospective MCR should be provided irrespective of whether a recovery plan or a finance scheme is being submitted. Supervisory authorities should be provided an overview of the current situation of the undertaking and not just focus on the part of the regulatory capital requirements for which a non-compliance has been identified.

In order to be able to assess whether the recovery plan or the finance scheme submitted by an undertaking is realistic, the supervisory authority needs information on the bases and methods used for the estimates the undertaking provides.

EIOPA expects undertakings to analyse why a non-compliance with the SCR or the MCR has occurred and to address any deficiencies that are identified as the cause for the breach of the regulatory capital requirements. Supervisory authorities are expected to follow-up on this and to ensure that the undertaking implements the necessary changes in a timely manner. Supervisory authorities should be aware of the causes for the non-compliance in the view of the undertaking as this may affect the assessment of the remedial measures the undertaking means to take.

Before supervisory authorities can approve a recovery plan or finance scheme, they need to know what remedial actions the undertaking has already taken, what further measures the undertaking plans to take and what is their immediate and anticipated effect. When looking at the effect of these measures, this should not be limited to the effect on the SCR and MCR but on the business of the undertaking in general.

The aim of the recovery should not be to just re-establish compliance with the SCR/MCR at a certain point in time, i.e. the last day of the recovery period, but to achieve a sustained recovery. This means that the undertaking should show that there is no material risk of another non-compliance in the short term.

A recovery plan or finance scheme requires the approval by the administrative, management or supervisory body (hereinafter "AMSB") before it is submitted to the supervisory authority. Supporting evidence should be provided to the supervisory

authority to show the approval of the recovery plan or finance scheme by the AMSB and whether there were any concerns before approval was given.

Undertakings have to submit estimates as part of the recovery plan or finance scheme. These estimates have to meet certain requirements in order to be able to serve as a basis for the supervisory assessment of the plan or scheme. In particular, the estimates have to be realistic and need to already include the remedial measures the undertaking plans to implement.

Whenever possible, information should be provided using the relevant quantitative reporting templates. Using the templates serves a harmonised approach and facilitates the supervisory authority to later compare the prospective data with the actual numbers submitted.

In order to assess the recovery plan or finance scheme the supervisory authority needs information about the overall financial situation of the undertaking at the end of the recovery period. Furthermore, the supervisory authority has to consider how the remedial measures will affect the undertaking concerned in the short term. Therefore the undertaking should provide information at least for the following additional time horizons: year-end information for the financial year in which the recovery period ends and year-end information for the subsequent financial year.

Information on reinsurance that supervisory authorities need for the assessment of the recovery plan or finance scheme is whether there are any specific changes to the reinsurance cover on account of the non-compliance with the SCR/MCR and remedial measures.

When there is non-compliance with the MCR the undertaking concerned will in most cases also be in non-compliance with the SCR. Only where the non-compliance with the MCR is owing to a lack of own funds eligible for covering the MCR rather than to an insufficient total amount of eligible own funds will an undertaking breach the MCR while still meeting the SCR. As the information to be included in a recovery plan and a finance scheme is the same, and the finance scheme is only about re-establishing compliance with the MCR and not the SCR, the question arises, whether an undertaking which at the same time does not comply with the SCR and the MCR should actually submit the same information twice for mostly overlapping periods of time.

EIOPA considers that it should be possible for an undertaking to submit one recovery plan/finance scheme that covers both the recovery from the non-compliance with the MCR and with the SCR with the necessary information only submitted once as long as the supervisory authorities still get the information specifically needed to assess whether the remedies proposed to re-establish compliance with the MCR are suitable for achieving this aim within the three months recovery period.

Supervisory approval of the submitted recovery plan or finance scheme requires that the information is as reliable and complete as can be expected of information that is collected outside the normal reporting cycle. Projections need to be realistic and proposed measures suitable to address the problem.

EIOPA also considers that depending on the circumstances, remedial measures could have pro-cyclical effects. In this case EIOPA would expect supervisory authorities to require the undertaking concerned to choose alternative measures that have a less detrimental effect.

For the recovery plan or finance scheme to be taken as realistic, the supervisory authority should be satisfied that there is no material risk of another non-compliance within a short timeframe following the end of recovery period.

Undertakings can only submit the recovery period and the finance scheme within the submission period set out in Articles 138 and 139 respectively. If they fail to do so or submit a plan or scheme that the supervisory authority cannot approve, the supervisory authority decides how the non-compliance is to be remedied. However, as long as the submission period has not expired, undertakings should be able to submit an improved recovery plan or finance scheme if the supervisory authority has decided not to approve the originally submitted plan or scheme.

On account of the option to allow the submission of a combined recovery plan and finance scheme, it is necessary to clearly set out that the supervisory authority may only approve the respective actions applied to comply with either the MCR or the SCR. In this case the undertaking concerned should also be able to submit an improved new document for the part that was rejected if there is still time left of the submission period.

Proposal

Following the analysis above, in EIOPA's view the delegated acts should be drafted as follows:

Content of the recovery plan and finance scheme

(1) The recovery plan and the finance scheme to be submitted by insurance or reinsurance undertakings to the supervisory authority according to Article 138(2) or Article 139(2) of Directive 2009/138/EC shall include the following in addition to the items identified in Article 142(1) of Directive 2009/138/EC:

- a) the prospective solvency capital requirement and the prospective minimum capital requirement at the end of the recovery period, the former split by risk modules where the undertaking applies the standard formula and by risk categories where the undertaking applies an internal model;
- b) the bases and methods used for deriving the estimates used, including the assumptions for the economic scenarios;
- c) the insurance or reinsurance undertaking's own analysis of the causes for the non-compliance;
- d) remedial measures it has already taken and remedial measures planned, including their time schedule, and their effects with regard to re-establishing compliance with the solvency capital requirement, minimum capital requirement or both and with regard to the overall business of the undertaking;
- e) the adequacy of the measures to avoid another non-compliance of the solvency capital requirement or minimum capital requirement in a short timeframe following the end of recovery period;
- f) supporting evidence of the approval of the recovery plan/finance scheme by the administrative, management or supervisory body and any concerns before approval was given.

(2) When the remedial measures planned include any commitments from third parties, the insurance or reinsurance undertaking should provide relevant supporting evidence of such commitments.

Forecast balance sheet and estimates

The forecast balance sheet and all estimates referred to in Article 142 (1) of Directive 2009/138/EC that are to be submitted by insurance or reinsurance undertakings as part of the recovery plan or finance scheme shall comply with the following:

- (a) they shall be based on realistic assumptions both in relation to the business of the insurance or reinsurance undertaking and economic scenarios;
- (b) they shall take into account the impact of the remedial measures the insurance or reinsurance undertaking concerned proposes to implement;
- (c) they shall be provided for at least three time horizons:
 - i) the end of the recovery period,
 - ii) the end of the financial year in which the recovery period ends;
 - iii) the end of the subsequent financial year;
- (d) they shall be provided using the relevant templates for regular supervisory reporting, wherever possible.

Overall reinsurance policy

The overall reinsurance policy to be submitted according to Article 142(1)(e) of Directive 2009/138/EC shall reflect any changes the insurance or reinsurance undertaking proposes to introduce with regard to its reinsurance policy and include information about the potential impacts of the proposed changes of the reinsurance programme.

Non-compliance with both the minimum capital requirement and the solvency capital requirement at the same time

When an insurance or reinsurance undertaking observes a non-compliance with the minimum capital requirement and with the solvency capital requirement at the same time, the supervisory authority may allow the insurance or reinsurance undertaking concerned to submit a combined finance scheme and recovery plan. In this case the combined finance scheme and recovery plan has to be submitted within the submission period applicable to the non-compliance with the minimum capital requirement.

Approval of the recovery plan and finance scheme

(1) The supervisory authority shall only approve a recovery plan or finance scheme where it considers that the plan or scheme is likely to result in the insurance or reinsurance undertaking concerned re-establishing compliance with the solvency capital requirement or minimum capital requirement within the available recovery period. This implies that the supervisory authority agrees that:

- a) the estimates provided by the insurance or reinsurance undertaking concerned are realistic;
- b) the information given by the insurance or reinsurance undertaking concerned is as complete as possible under the circumstances and sufficiently reliable;
- c) the projections by the insurance or reinsurance undertaking concerned of the future solvency capital requirements or minimum capital requirements are realistic;
- d) the measures the insurance or reinsurance undertaking concerned proposes to take in order to increase the level of its eligible own funds or reduce its risk profile within in the recovery period are adequate;

e) the recovery plan or finance scheme does not have potential significant pro-cyclical effects.

(2) The supervisory authority shall not approve the recovery plan or finance scheme if, on the basis of the information supplied, considers it likely that the insurance or reinsurance undertaking concerned will face another non-compliance within a short timeframe following the end of the recovery period.

(3) Where the supervisory authority, before the expiry of the submission period, concludes that a recovery plan or finance scheme cannot be approved, it shall explain the reasons for the non-approval and allow the submission of a revised recovery plan or finance scheme, as long as it is submitted within the original submission period.

(4) Where a combined finance scheme and recovery plan is submitted for approval, the supervisory authority may only approve the respective actions applied to comply with either the minimum capital requirement or the solvency capital requirement. In this case, the supervisory authority shall explain the reasons for the partial rejection and allow the submission of a revised combined finance scheme and recovery plan, as long as it is submitted within the original submission period.

Supervisory powers in deteriorating financial conditions

Analysis

EIOPA considers that it is possible to identify supervisory measures that can be taken in case of deteriorating financial conditions, but that this list of measures should not be exhaustive. There needs to be flexibility as it is not possible to foresee what situations could arise and which measures could then be appropriate to ensure policyholder protection. It is also not deemed possible to describe which measures should be taken in which circumstances. In EIOPA's view it is however feasible to name the criteria/factors that supervisory authorities should take into account when taking a decision on the measures they want to employ.

EIOPA holds that with regard to supervisory measures a distinction should be made between a situation where the deterioration of financial conditions takes place during a non-compliance with the SCR and a situation where the undertaking is in breach of the MCR. In the latter case, a withdrawal of the authorisation is mandatory under Article 144(1) if the non-compliance is not remedied within three months. A further deterioration of the financial conditions instead of an improvement of the situation is a very serious problem and the supervisory authority should consider carefully whether the undertaking can still be considered capable of timely recovery. In such circumstances, according to Article 141 the supervisory authority is empowered to take all measures necessary to safeguard the interest of the policyholders. Therefore, if the deterioration of the financial conditions leads the supervisory authority to consider that the original finance scheme is manifestly inadequate, a withdrawal of the authorisation should be appropriate even before the three months recovery period has elapsed in order to protect policyholders.

When the undertaking concerned is in non-compliance with the SCR the supervisory authority in deciding on supervisory measures should take into account the causes for the non-compliance as, where possible, supervisory measures should address the root of the problem. With regard to the severity of the supervisory measures that are appropriate it is important to consider the extent of the original non-compliance and the extent of the subsequent deterioration. The higher the degree of non-compliance, the more severe the supervisory measures should be.

Further relevant factors in the decision-making of the supervisory authority should be the nature of the business of the undertaking concerned and the level of implementation of the measures included in the recovery plan or finance scheme.

The supervisory authority needs to monitor the recovery of the undertaking. Where the regular information is not adequate for following up on undertakings that face deteriorating financial conditions, the supervisory authority should consider imposing additional reporting/information requirements.

More generally, the supervisory authority when deciding on supervisory measures should take into account any measures the undertaking concerned itself has considered to be appropriate in case of financial stress. Such information could be found in contingency plans the undertaking has developed. Supervisory authorities should also not just focus on the short term problem; they should take into account the longer term consequences of their intervention.

Article 28 already requires that the supervisory authority shall duly consider the potential impact of their decisions on the stability of the financial systems concerned in the European Union. However, in EIOPA's view it is still appropriate to explicitly state in the regulatory technical standards that supervisory authorities shall take due care to avoid pro-cyclical effects.

Proposal

Supervisory measures in deteriorating financial conditions

(1) Where the financial conditions of an insurance or reinsurance undertaking that does not comply with its solvency capital requirement or its minimum capital requirement deteriorate further after the first observance of the non-compliance, the supervisory authority shall consider taking one or more measures including the following:

- a) measures aimed at reducing the risk profile, such as
 - i) requiring the insurance or reinsurance undertaking concerned to refrain from underwriting new risks, or to renew pending contracts, in certain lines of business where this would increase its capital requirements;
 - ii) requiring the insurance or reinsurance undertaking concerned to change its asset portfolio with the aim of reducing the market and credit risk;
- b) measures aimed at limiting or preventing a reduction of financial resources, such as prohibiting the free disposal of assets;
- c) imposing additional reporting requirements to enable improved monitoring of the insurance or reinsurance undertaking concerned, such as
 - i) increasing the frequency of the reporting for certain templates;
 - ii) requiring regular reports on the financial condition of the insurance or reinsurance undertaking;
 - iii) asking for an updated medium-term capital management plan;
 - iv) asking the undertaking to inform the supervisory authority prior to implementing any significant decision.
- d) reorganisation measures to preserve or restore the financial situation of the insurance or reinsurance concerned.

(2) In deciding on which measures to take where the financial conditions of an insurance or reinsurance undertaking that does not comply with its solvency capital requirement deteriorate further, the supervisory authority shall take into account:

- a) the causes of the non-compliance;
- b) the extent of the initial non-compliance and the extent of the deterioration of the financial conditions;
- c) the relation between the solvency capital requirement and the minimum capital requirement,
- d) the nature of the business of the insurance or reinsurance undertaking concerned;
- e) the level of implementation of the measures foreseen in the recovery plan;
- f) the adequacy of the regular information submission for following-up on the solvency position of the insurance or reinsurance undertaking concerned until a full and sustained recovery is achieved.

(3) Where the financial conditions of an insurance or reinsurance undertaking that does not comply with its minimum capital requirement deteriorate further, the supervisory authority shall consider whether it is still realistic that the implementation of the finance scheme will re-establish compliance with the minimum capital requirement. If in view of the deteriorating financial conditions the finance scheme is

deemed to be manifestly inadequate, the supervisory authority shall withdraw the authorisation of the insurance or reinsurance undertaking.

(4) When deciding on supervisory measures it should take, the supervisory authority shall consider any remedial measures the undertaking concerned has envisaged as part of contingency plans the undertaking has drawn up for times of financial stress.

(5) The supervisory authority shall take due care to avoid pro-cyclical effects and shall also carefully balance the need to improve the financial conditions of the insurance or reinsurance undertaking at short notice with any longer term adverse consequences these measures may have for the business of the undertaking.

Annex I: Impact Assessment

Section 1: Procedural issues and consultation of interested parties

EIOPA received a call for advice from the Commission to provide technical advice to assist the Commission on the possible content of the delegated acts on the following issues:

- The recovery plan referred to in Article 138 (2) of Solvency II Directive;
- The finance scheme referred to in Article 139 (2) of Solvency II Directive;
- With respect to Article 141 of Solvency II Directive (supervisory powers in deteriorating financial conditions).

The draft regulatory technical standards on these issues to be developed by EIOPA, will be adopted as delegated acts following the sunrise clause in article 301b of Solvency II.

According to article 10 of EIOPA Regulation, EIOPA conducts analysis of costs and benefits when drafting regulatory technical standards. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

The draft technical advice and its Impact Assessment will be subject to public consultation.

Section 2: Problem definition

To ensure consistent harmonisation with regard to the recovery plan and the finance scheme referred to in Articles 139 and 141 of the Solvency II Directive as well as with regard to the supervisory powers that national competent authorities may wield in deteriorating financial conditions where insurance or reinsurance undertakings already are in non-compliance with their Solvency Capital Requirement (hereinafter SCR) or their Minimum Capital Requirement (hereinafter MCR), national competent authorities shall require the same information from undertakings in financial difficulties and exercise their powers in a consistent way while taking into account the specificities of each individual case. EIOPA shall provide technical advice to the European Commission on regulatory technical standards with regard to the recovery plan, the finance scheme and supervisory powers in deteriorating financial conditions.

The absence of implementing measures might result in the following undesirable effects:

- (a) National competent authorities requiring different additional information from that envisaged in article 142 and a different level of detail when asking insurance or reinsurance undertakings to submit a recovery plan or finance scheme;
- (b) National competent authorities applying different supervisory powers where insurance or reinsurance undertakings face deteriorating financial conditions;
- (c) National competent authorities applying different criteria when approving a recovery plan or finance scheme thus creating uncertainty for undertakings.

Baseline

When analysing the impact from proposed policies, the Impact Assessment 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 intervention.

The baseline for this Impact Assessment Report 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.

In particular the baseline will include:

- The content of Directive 2009/138/EC, as amended by Directive 2014/51/EU;
- The relevant Implementing Measures.

Article 143(2) of Solvency II Directive contains the legal requirement for EIOPA to develop draft regulatory standards on the recovery plan, finance scheme and supervisory powers in deteriorating financial conditions. According to Article 301b (1) in connection with Article 301a of the Directive, the European Commission will adopt these standards as delegated acts. In its letter from August 2014, the EU Commission has requested that EIOPA should provide technical advice for these delegated acts.

Section 3: Objectives

Objective 1: To promote a consistent and harmonised approach to undertakings in non-compliance with capital requirements.

Objective 2: To ensure an equivalent level of protection for policyholders and beneficiaries where undertakings are in non-compliance with capital requirements.

Objective 3: To identify the information required from undertakings when they are in non-compliance with the SCR or the MCR.

These objectives correspond to the main objective of the Directive to protect policy holders and beneficiaries and the objective to enhance convergence of supervisory practices.

Section 4: Policy options

With the intention to meet the objectives set out in the previous section, EIOPA has given consideration to the following issues:

- (1) how important it is to have a combined recovery plan and finance scheme submitted by the undertaking concerned where non-compliance with the MCR concurs with a non-compliance with the SCR;
- (2) the sustainability of the financial recovery the undertaking concerned has to show for a recovery plan or finance scheme to be approvable;
- (3) list of supervisory measures, national competent authorities may take in deteriorating financial conditions.

In this context, the following options have been analysed:

Policy issue 1: Concurrence of a non-compliance with the MCR with a non-compliance with the SCR.

- Option 1.1: Submission of a separate finance scheme and recovery plan.
- Option 1.2: Submission of a combined recovery plan and finance scheme.

Policy issue 2: Sustainability of the recovery.

- Option 2.1: Re-establish compliance with the SCR or MCR at the end of the recovery period.
- Option 2.2: Compliance with the SCR and MCR for some time after the end of the recovery period.

Policy issue 3: Supervisory measures in deteriorating financial conditions.

- Option 3.1: Exhaustive list of measures to be taken.
- Option 3.2: Non-exhaustive list of potential measures.

Section 5: Analysis of impacts.

Policy issue 1. Concurrence of a non-compliance with the MCR with a non-compliance with the SCR

While it is possible that a non-compliance with the MCR occurs on account of the quality of the own funds for covering the MCR of an undertaking rather than the total amount of eligible own funds being insufficient, this is not expected to be the normal situation of the undertaking with regard to its MCR. In most cases where the MCR is breached the undertaking concerned will suffer from a lack of eligible own funds that results in a breach of the SCR as well. Where the undertaking does not experience deteriorating financial conditions after non-compliance with the SCR that ultimately lead to non-compliance with the MCR as well but immediately drops below both the SCR and the MCR it would have to submit a finance scheme within one month of identifying the breach of the MCR and a recovery plan within two months of identifying the breach of the SCR. EIOPA has considered whether it would be appropriate in this situation for a national competent authority to be able to allow the submission of one combined recovery plan and finance scheme that covers both the re-establishment of compliance with the MCR and the SCR.

Option 1.1 Submission of a separate finance scheme and recovery plan

This is the requirement according to the Directive which sets out different submission periods, one month for the submission of a finance scheme and two months for the submission of the recovery plan.

Option 1.2 Submission of a combined recovery plan and finance scheme

The requirements on the content of the finance plan and the recovery plan are the same. Therefore submitting some information only once would make it easier for undertakings and national competent authorities to consider recovery as one period instead of dealing with two separate recovery periods that overlap within the first three months.

The downside for undertakings is that in order to conform to the timelines set out in the Directive a combined approach requires that the information is submitted within the stricter of the two submission periods, i.e. within one month, even where the recovery concerns the SCR. However, submitting one document only is considered as something supervisory authorities may allow not something that is or can be required.

So this “option” would only be used where it does not create time problems for the undertaking.

‘Other stakeholders’ interests

The issue is of interest for national competent authorities and insurance and reinsurance undertakings only. Other industry stakeholders and policyholders are not affected by the form or the timeframe in which the necessary information concerning the recovery from the breach of the MCR and the SCR are submitted to the supervisory authority.

Costs/benefits impact

Having to submit the full information twice and communication with the national competent authority “separately” for both breaches is expected to be more costly for undertakings compared to providing most of the information only once with a recovery from the breach on the MCR within three months treated as a specific “milestone”. For supervisory authorities a separate approach would also produce higher administrative expenses. An approach where combined recovery plan and finance scheme is submitted could help both undertakings and supervisory authorities in taking a more holistic view of the financial difficulties.

Policy issue 2. Sustainability of the recovery

According to the Directive, where non-compliance with the SCR occurs, the insurance or reinsurance undertaking concerned has to take the necessary measures to achieve, within six months from the observation of non-compliance with the Solvency Capital Requirement, 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. The Directive also requires that compliance with regulatory capital requirements is continuous. Potential acute problems with the solvency position have to be notified to the supervisory authority with insurance and reinsurance undertakings being required to immediately inform the supervisory authority where there is a risk of non-compliance in the following three months. In light of this, EIOPA has considered whether it is sufficient for an insurance or reinsurance undertaking to show that it is able to meet the SCR or MCR at the end of the recovery period or whether it is necessary to provide additional assurance that there will be no need to notify the supervisory authority of a potential non-compliance within a short timeframe following the end of the recovery period.

Option 2.1 Re-establish compliance with the SCR or MCR at the end of the recovery period

Asking only for full compliance with the SCR/MCR at the last day of the recovery period gives undertakings a clear and certain view that the goal is to meet the capital requirement as calculated for that point in time.

The downside is, in the light of continuing volatility, that a recovery that is tailored to achieve coverage of the SCR/MCR at a certain point in time carries the risk of another non-compliance soon afterwards.

Option 2.2 Compliance with the SCR and MCR ensured for some time after the end of the recovery period

Asking for a buffer that ensures that there is no risk of a breach of the SCR or MCR within a short term after the end of the recovery period provides better protection for policyholders.

Where an undertaking notifies the supervisory authority of a risk on non-compliance with regulatory capital requirement, the supervisory authority would have to consider initiating steps to ensure that the risk does not materialise. From the supervisory perspective it is therefore preferable that the initiative for further strengthening of the solvency position remains with the undertaking once the solvency position has been compromised.

The option requires more from undertakings as they have to demonstrate to the national competent authority - with the risk that the national competent authority does not accept this explanation - what kind of buffer is necessary so that undertaking and supervisory authority can be reasonably sure that there is not another breach of the SCR/MCR within a short term after of the end of the recovery period. On the other hand it is in the undertakings' own interests to avoid a situation where financial problems are recurring.

Other stakeholders interests

Policyholders and beneficiaries have an interest that undertakings in financial difficulties not only just re-establish compliance with regulatory requirements at a certain point in time but also that the recovery is sustainable.

Costs/benefits impact

Undertakings have to ensure that compliance with regulatory capital requirements is continuous in any case. So the task of the undertaking is not finished with re-establishing compliance at the end of the recovery period; additional efforts are necessary to ensure against the recurrence of non-compliance. Having to provide such assurance within the recovery period may incur costs at an earlier point in time. On the other hand the degree to which such assurance is provided will influence the level of monitoring by the supervisory authority after the expiry of the recovery period.

Policy issue 3. Supervisory measures in deteriorating financial conditions

As part of the regulatory technical standards EIOPA has to specify supervisory measures that could be taken in deteriorating financial conditions. For this EIOPA considered whether an exhaustive list of potential supervisory measures should be developed.

Consideration was also given as to whether set out the circumstances under which the measures should potentially be implemented. It was however felt that this would not enhance harmonisation or provide more predictability for undertakings as any such descriptions would have to remain pure non-binding "suggestions" since the individual situation of the undertaking concerned and the external situation in which the financial difficulties take place will always need to be taken into account. It is not considered possible to develop "If X then Y" solutions for deteriorating financial situations that ensure that supervisory measures are proportionate and reflect the level and the duration of the deterioration of the solvency position as required by Article 141, second subparagraph of the Directive.

Option 3.1 Exhaustive list of measures to be implemented

Providing an exhaustive list of measures for national competent authorities to choose from, could enhance harmonisation and ensure that undertakings do not face more

onerous supervisory measures in some Member States than in others. Such differences could potentially affect the competitive situation considerably. For undertakings an exhaustive list of supervisory measures would also make the exercise of supervisory powers more foreseeable and reduce uncertainty about the impact supervisory measures may have on the undertaking.

For national competent authorities a closed list of potential measures would reduce burden as they do not have to decide what would be the appropriate measures under the circumstances. However, a closed list may not provide appropriate solutions in certain circumstances and result in no measures or fewer or no appropriate measures being taken with detrimental effects on policyholder and beneficiary protection.

Option 3.2 Non-exhaustive list of potential measures

A non-exhaustive list of potential measures provides more flexibility on national competent authorities which however is accompanied by more responsibility as national competent authorities also have to consider other measures not included in the regulatory technical standards and assess their appropriateness and proportionality as well as their potential effects on financial stability. This flexibility could result in differences in supervisory approaches as some national competent authorities may exercise powers not included in the list. For undertakings the additional flexibility implies increased uncertainty and unpredictability as national competent authorities could intervene with quite specific solutions in their business. This however may indirectly have a beneficial effect on compliance as it may encourage undertakings to avoid deteriorating financial conditions in order not to be subject to unpredictable and potentially more onerous supervisory measures.

'Other stakeholders' interests

From policyholders' and beneficiaries' point of view maximum flexibility of the national competent authorities to take any measure appropriate to remedy the deteriorating financial conditions is paramount.

Cost/benefits impact

The options do not result in additional administrative costs for undertakings whereas option 3.2 would increase administrative costs for national competent authorities slightly by requiring additional considerations and assessments. These additional costs are outweighed by the greater flexibility that option 3.2 provides for supervisory authorities.

Financial stability

The regulatory technical standards as such will have no direct impact on financial stability. The requirements on the content of the recovery plan and the finance scheme do not per se affect financial stability, it is the measures an insurance or reinsurance undertaking in financial difficulties might propose to take to re-establish compliance with the MCR or the SCR that could have an impact on financial stability. Since the technical advice does not envisage that national competent authorities should be required to approve a recovery plan or finance scheme irrespective of the effect that the proposed remedial measures may have on financial stability, this part of the technical advice ensures that any effect of the regulatory technical standards on financial stability would be positive. Concerning supervisory measures in deteriorating financial conditions the list of potential measures that national competent authorities are supposed to take into consideration contains measures that could potentially have an impact on financial stability. However, national competent authorities are not required to exercise any of these powers. On the contrary they are obliged to consider

the impact of any such measures on financial stability under the specific circumstances of the case they have to decide, any effect of this part of the technical advice on financial stability should be beneficial as well.

Regarding the options, policy options 1 and 2 are neutral with regard to financial stability. However, for policy option 3 a decision to use an exhaustive list of supervisory measures in deteriorating financial conditions may indirectly provide more risk for financial stability as national competent authorities could be tempted to take a measure with a potential effect for financial stability in the specific situation when no other measures from the list are feasible rather than do nothing at all.

Social impact

Neither the regulatory technical standards nor the considered options are expected to have any social impacts.

Section 6: Comparing the policy options

The three policy issues and the options attached to each of them have been analysed independently.

- On policy issue 1 (**Concurrence of a non-compliance with the MCR with a non-compliance with the SCR**), it is considered that option 1.2 (*Submission of a combined recovery plan and finance scheme*) would provide a more practicable approach, making this the preferred option.
- On policy issue 2 (**Sustainability of the recovery**) option 2.1 (*Re-establish compliance with the SCR or MCR at the end of the recovery period*) carries the risk that undertakings do not implement sufficient measures to ensure that they recover from financial difficulties and re-establish not just compliance but also continuous compliance with regulatory capital requirements. Therefore option 2.2 (*Compliance with the SCR and MCR probable for some time after the end of the recovery period*) that requires undertakings to ensure they do not immediately have to notify the national competent authority of a potential new breach immediately after re-establishing compliance with the MCR or SCR, is the preferred option.
- On policy issue 3 (**Supervisory measures in deteriorating financial conditions**), providing more flexibility to national competent authorities to choose supervisory measures that are appropriate and proportionate in a given situation and ensure that policyholders and beneficiaries interests are safeguarded is considered to be more important-than aiming for more harmonisation by limiting the scope of potential supervisory measures. When an undertaking is in non-compliance with the MCR or SCR and faces deteriorating financial conditions the protection of policyholders and beneficiaries is key and should not be jeopardised in order to provide more predictability to undertakings with regard to potential supervisory measures.

Overall evaluation

As drafted, and after consideration of the various options, it is considered that the technical advice sets out requirements on the recovery plan, finance scheme and supervisory measures in deteriorating financial conditions in a manner that ensures an adequate level of harmonisation in supervisory practices. This would leave national competent authorities with sufficient flexibility to act appropriately in the interests of

policyholder protection in any given situation where insurance or reinsurance undertakings are in non-compliance with regulatory capital requirements thus putting policyholders and beneficiaries at risk.