



EIOPA-CP-14/053

27 November 2014

Consultation Paper
on
the proposal for draft
Implementing Technical Standards
on
capital add-ons

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Responding to this paper

EIOPA welcomes comments on the Consultation Paper on the proposal for draft Implementing Technical Standards on capital add-ons.

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Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published.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 drafting Technical Standards in accordance to Articles 10 and 15 of the EIOPA Regulation.

This Consultation Paper presents the draft Technical Standards and a technical annex where relevant.

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. Draft Technical Standard



EUROPEAN COMMISSION

Brussels, 29.6.2011
C(20..) yyy final

COMMISSION DELEGATED REGULATION (EU) No .../..

of []

COMMISSION IMPLEMENTING REGULATION (EU) No .../.. laying down implementing technical standards with regard to the procedures for decisions to set, calculate and remove capital add-ons according to Directive 2009/138/EC of the European Parliament and of the Council

of []

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 (Solvency II) and in particular Article 37(8) thereof,

Whereas:

- (1) This Regulation establishes the procedures to be followed by the supervisory authorities when deciding on setting, calculating or removing capital add-ons.
- (2) This Regulation is based on the draft implementing technical standards submitted by the European Insurance and Occupational Pensions Authority to the Commission.
- (3) The European Insurance and Occupational Pensions Authority has conducted open public consultations on the draft implementing technical standards on which this Regulation is based and analysed the potential related costs and benefits and requested the opinion of the

Insurance and Reinsurance Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1094/2010.

HAS ADOPTED THIS REGULATION:

Article 1

Notification before setting a capital add-on

- (1) Prior to setting a capital add-on, the supervisory authority shall inform the insurance or reinsurance undertaking concerned of its intention, together with the reasons for setting a capital add-on.
- (2) The supervisory authority shall specify a timeframe for the insurance or reinsurance undertaking to respond to this notification. The supervisory authority shall take into consideration the information provided by the insurance or reinsurance undertaking before taking its final decision to set a capital add-on.
- (3) Where the supervisory authority deems it necessary to take urgent action or it considers that a notification according to paragraph 1 may cause undue delay to the detriment of policyholders or beneficiaries, paragraph 1 shall not apply.

Article 2

Co-operation between the supervisory authority and the insurance or reinsurance undertaking

- (1) The insurance or reinsurance undertaking shall co-operate with the supervisory authority and provide it with any information that the supervisory authority considers relevant to take a decision to set, calculate, or remove a capital add-on.

Article 3

Timeframe

- (1) In determining the timeframe for any information request addressed to the insurance or reinsurance undertaking, the supervisory authority shall take into account all relevant factors under [Articles 276, 277, 278 and 279 of the Implementing Measures in particular the likelihood and severity of any adverse impact on policyholders and beneficiaries.
- (2) The insurance or reinsurance undertaking shall notify the supervisory authority immediately if it considers that it will not be able to meet the timeframe for provision of information set out in the information request by the supervisory authority.

Article 4

Communicating the decision to set a capital add-on

- (1) The supervisory authority shall communicate in writing its decision to set a capital add-on to the insurance or reinsurance undertaking.

- (2) The communication provided by the supervisory authority shall be sufficiently detailed to enable the insurance or reinsurance undertaking to understand the actions or measures that need to be taken, or the specific circumstances of the deficiencies that need to be remedied in order for the capital add-on to be removed. In particular, the communication shall include:
- (a) the reasons for setting a capital add on;
 - (b) the methodology for calculating the capital add-on and the amount of the capital add-on;
 - (c) the date from which the capital add-on shall be applicable;
 - (d) the timeframe, where relevant, in which the insurance or reinsurance undertaking shall implement measures and actions in order to remedy the deficiencies that led to the decision to set the capital add-on;
 - (e) the content and frequency of any progress reports according to Article 5.

Article 5

Progress reports

- (1) If requested by the supervisory authority to provide progress reports, the insurance or reinsurance undertaking shall communicate the progress it has made in taking actions or measures to remedy the deficiencies that led to the supervisory authority setting the capital add-on.

Article 6

Review of the capital add-on

- (1) Without prejudice to the annual review required by Article 37(4) of Directive 2009/138/EC, the supervisory authority shall review the imposed capital add-on if there is a material change in the circumstances of the deficiencies that led to the setting of the capital add-on.
- (2) The supervisory authority shall consider a change in circumstances to be material at least where:
- (a) the insurance or reinsurance undertaking has implemented appropriate measures and actions in order to remedy the deficiencies that led to the decision to set the capital add-on; or
 - (b) the circumstances, which led the supervisory authority to consider the

requirement to use an internal model to be ineffective or inappropriate no longer apply.

Article 7

Process of changing or removing a capital add-on

- (1) In deciding whether a capital add-on should be removed, reduced or increased in amount, the supervisory authority shall take into account:
 - (a) information obtained during the process of setting the capital add-on and subsequent supervisory activity, and other information obtained through the supervisory review process;
 - (b) information arising from any progress reports submitted by the insurance or reinsurance undertaking, whether requested by the supervisory authority or otherwise;
 - (c) any other relevant information indicating there may have been a material change in the circumstances of the deficiencies, which led to the setting of the capital add-on.

Article 8 –

Communicating the decision to change, maintain or remove a capital add-on

- (1) The supervisory authority shall communicate in writing its decision to change, maintain or remove a capital add-on and the effective date of this decision to the insurance or reinsurance undertaking on a timely basis.
- (2) Where the supervisory authority decides to change the capital add-on, Article 4(2) shall apply.

Article 9

Entry into force

- (1) This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.
- (2) This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, []

[For the Commission

The President]

[On behalf of the President]
[Position]

2. Annex I: Impact Assessment

Section 1: Procedural issues and consultation of interested parties

- 2.1. In accordance with article 37 (6) of the Solvency II Directive, "EIOPA shall develop draft implementing technical standards on the procedures to be followed for decisions to set, calculate and remove capital add-ons" (hereinafter CAO).
- 2.2. Article 15 of EIOPA Regulation states that the potential related costs and benefits of the Implementing Technical Standards (hereinafter ITS) should be conducted, unless such analyses are disproportionate in relation to the scope and impact of the draft ITS concerned or in relation to the particular urgency of the matter. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.
- 2.3. This Impact Assessment covers only those areas of discretion that were exercised when developing the ITS on capital add-ons, to ensure that supervisory authorities implement clear, transparent and harmonized procedures for setting, calculating and removing capital add-ons.
- 2.4. The impact assessment was prepared during the drafting of the ITS. Experts on CAO and system of governance from national competent authorities provided input into the drafting and these responses have been used to inform the impact assessment.
- 2.5. The draft ITS and its Impact Assessment are subject to public consultation.

Section 2: Problem Definition

- 2.6. Following the supervisory review process, the Solvency II Directive states that the national competent authorities have the power to impose a capital add-on to the Solvency Capital Requirement (SCR) applicable to insurance and reinsurance undertakings. The imposition of a capital add-on should only be adopted under exceptional circumstances, in the cases listed in article 37 of the Directive.
- 2.7. As regards to procedures to be followed by national competent authorities in exercising such power, the requirements set out in article 37 of the Directive are high-level and therefore allow for substantial variation in practice regarding the setting, calculating and removing of CAO. The ITS should facilitate convergence of the regulatory procedures whereby supervisory authorities consider the specific circumstances pertaining to a given insurance or reinsurance undertaking and any potential CAO.
- 2.8. A description of the procedures to be followed is deemed necessary addressing in particular the following issues:
 - Prior notification by the supervisory authorities to the undertakings of their intention to impose a CAO;
 - Time period for provision of requested information by the undertaking to the supervisory authority.

Baseline

- 2.9. 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.
- 2.10. 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.
- 2.11. In particular the baseline will include:
- The content of Directive 2009/138/EC as amended by Directive 2014/51/EU.
 - The relevant Implementing Measures.

Section 3: Objectives pursued

- 2.12. Objective 1: To ensure a consistent approach to the procedures for setting, calculating and removing add-ons – consistency in application is essential if the goals of policyholder protection and level playing field are to be promoted.
- 2.13. Objective 2: To ensure clear communication between the supervisory authority and undertakings throughout the procedure of setting, calculating and removing capital add-ons.
- 2.14. These policy objectives correspond to the following specific and general objectives for the Solvency II Directive:
- General objectives
 - enhanced policyholder protection.
 - Specific objectives
 - advanced supervisory convergence and cooperation;
 - increased transparency;
 - improved risk management of EU undertakings.
 - Operational objectives
 - harmonised supervisory methods, powers and reporting.
- 2.15. A CAO is a supervisory measure intended to help to ensure regulatory capital establishes an appropriate degree of protection for policyholders. Undertakings with levels of risk that are not adequately reflected in the assumptions underlying the calculation of their SCR may thus be required to hold higher levels of capital to guard against the risks. As CAO will be publicly disclosed, they also serve as a signal to the market regarding an undertaking's risks, further improving market transparency and discipline. This may stimulate improvements in risk management, as well as the better alignment of the SCR with the undertaking's risk profile.

Section 4: Policy options

Policy Issue 1 - Prior notification by the supervisory authorities to the undertakings of their intention to impose a CAO

- 2.16. Whether to give the supervisory authority an option not to provide advanced notice to an undertaking of its intention to impose a CAO, depending on the circumstances, is an important policy choice. If the supervisory authority chose not to disclose its intention to impose a CAO, an undertaking may be put in a disadvantaged position as it would not be able to provide information and justifications which mitigate or negate the need for a CAO.
- 2.17. Conversely, if the supervisory authority always had to notify the undertaking before imposing a CAO, and should immediate additional capital be needed, then policyholders and beneficiaries may be adversely impacted by the delay.
- 2.18. **Option 1.1:** To give the supervisory authority the option whether or not to notify the undertaking of its intention to set a CAO, in certain specified circumstances.
- 2.19. **Option 1.2:** To make it obligatory for the supervisory authority to notify the undertaking of its intention to impose a CAO irrespective of the circumstances.

Policy Issue 2 – Time period for provision of requested information by the undertaking to the supervisory authority

- 2.20. Undertakings should fully co-operate with supervisory authorities throughout the procedure of setting, calculating and removing capital add-ons. According to Article 35 of the Directive Member States shall require undertakings to submit to the supervisory authorities the information which is necessary for the purposes of supervision, including the ability to assess the risks faced by that undertaking.
- 2.21. However, it is unclear whether the ITS should confer upon the supervisory authority the ability to set a timeframe within which this information shall be delivered within a case-specific timeframe determinable by the supervisory authority or whether time limits should be pre-defined. By prescribing the timescales for cooperation, undertakings will be more certain of what is expected of them. However, it would be difficult to define in advance what may be a reasonable timescale in a variety of circumstances.
- 2.22. Option 2.1: The ITS should confer upon the supervisory authority, the ability to define the timeframe which the undertaking should be given to meet any information request.
- 2.23. Option 2.2: The ITS should pre-define the timeframes which the undertaking should be given to meet any information request.

Section 5: Analysis of impacts

Policy Issue 1 - Prior notification by the supervisory authorities to the undertakings of their intention to impose a CAO

Option 1.1: To give the supervisory authority the choice whether or not to notify the undertaking of its intention to set a CAO, in certain specified the

circumstances.

2.24. Benefits

- Provides the supervisory authority with flexibility and the ability to act quickly if necessary;
- Ensures that the interests of policyholders and beneficiaries are not adversely affected by delays in imposing a CAO.

2.25. Costs

- No costs identified for EIOPA or policyholders. Potential significant cost for undertaking, for the undertaking cannot provide additional information that could mitigate or negate the need for a CAO;
- Not being forewarned of an impending CAO could make it more difficult for the undertaking concerned to raise additional capital where this is necessary on account of the CAO before the CAO becomes common knowledge;
- Possible divergence of application across Member States.

Option 1.2: To make it obligatory for the supervisory authority to notify the undertaking of its intention to impose a CAO with no exception.

2.26. Benefits

- Provides certainty for undertakings and supervisory authorities alike as to whether undertakings should be notified of an intention to set a CAO

2.27. Costs

- Supervisory authorities may not be able to act quickly should immediate action be desirable, due to the obligation to notify the undertaking of their intention to set a CAO. This may have adverse implications for policyholders and beneficiaries.

Policy Issue 2 – Time period for provision of requested information by the undertaking to the supervisory authority

Option 2.1: The ITS should confer upon the supervisory authority, the ability to define the timeframe which the undertaking should be given to meet any information request.

2.28. Benefits

- Provides flexibility and the ability for supervisory authorities to use judgement regarding the specific information being requested when assessing the timeframe within which an undertaking might reasonably provide such information to set the CAO. This ensures that no more time than necessary is lost over collecting the necessary information for deciding about a CAO.

2.29. Costs

- Undertakings cannot be certain of the timescale within which information may need to be supplied;
- The flexibility conferred upon supervisory authorities could lead to a divergence of application across Member States.

Option 2.2:

The ITS should pre-define the timeframes which the undertaking should be given to meet any information request.

2.30. Benefits

- Provides clarity to undertakings and supervisory authorities and would increase consistency of application across National Competent Authorities.

2.31. Costs

- There is a risk in limiting the supervisory authority's ability to act in a case-specific manner, and possibly adversely affecting policyholders and beneficiaries as in some cases more time than appropriate is taken before the supervisory authority is provided with the information it needs to decide on the CAO;
- It is impossible to establish in advance the type of information that might be needed for every type of risk profile or governance deviation that could arise, and thus the timeframe within which an undertaking might reasonably provide such information;
- Fixed timeframes will be disadvantageous for undertakings in some cases as supervisory authorities cannot allow for a longer timescale even where this is considered to be appropriate.

Section 6: Comparing the options

Policy Issue 1 - Prior notification by the supervisory authorities to the undertakings of their intention to impose a CAO

2.32. The preferred option is Option 1.1: the supervisor does not have to notify the undertaking of its intention to set a CAO under certain specific circumstances. This option has been chosen because it provides the supervisory authority with flexibility and the ability to act quickly if necessary. The other options have been disregarded because supervisory authorities may not be able to act quickly in response to problems. This could jeopardize policyholder protection.

Undertakings

2.33. Regarding undertakings the preferred option may lead to hardship in some cases as undertakings that were notified of the supervisory authority's intention beforehand might have been able to avoid or reduce the CAO as they could have provided additional information that might have persuaded the supervisory authority not to set a CAO. However, if this is the situation, the undertaking concerned could still provide the relevant information after the CAO is set in which case the CAO would be removed or reduced by the supervisory authority and in the former case would only be in place for a short time period. One risk of disadvantage that remains for undertakings is that the supervisory authority does not allow for the public disclosure of the CAO to be postponed until it has assessed the additional information presented by the undertaking concerned. This could however be mitigated

by the undertaking publishing information that the CAO was removed as unjustified from the start where the additional information leads the supervisory authority to remove the CAO. What remains for the undertaking concerned is the risk that a CAO that could have been avoided or would have been smaller with prior notification could lead to a breach of the SCR, unnecessarily forcing the undertaking to start implementing measures for dealing with the non-compliance.

Supervisory authorities

- 2.34. For NSAs the policy confers greater responsibility as supervisory authorities are expected to use the option to set a CAO without prior notification sparingly, carefully weighing the need to provide appropriate policyholder protection against the costs for undertakings if they were deprived of the opportunity to defend themselves against the CAO and the probability of a possible defence being successful. With the policy in place, the option to set a CAO without prior notification will be something for the supervisory authority to check out whenever a CAO is considered. Not having the option would make the process of setting a CAO easier for the supervisory authority as no justification is needed for either using or not using the option. However this is considered to be a minor consideration; providing an appropriate level of protection of policyholder and beneficiaries takes priority over facilitating the work of supervisory authorities.
- 2.35. The selection of the preferred option has required a tradeoff between improving flexibility for NSAs and greater uncertainty for undertakings. More weight has been given to improving flexibility for NSAs, because the main goal of Solvency II is policyholder protection. We expect this to be aligned with the ability of NSAs to assess CAO application on a case-by-case basis.

Financial stability

- 2.36. The policy of no prior notification in specific circumstances could in some cases result in a short term CAO where no CAO should have been set as the undertaking concerned can demonstrate that there are good reasons not to set a CAO. Where the undertaking concerned is important for the market and the setting of a considerable CAO becomes public knowledge, this could lead to repercussions for financial stability where the market acts negatively on the disclosure. However, supervisory authorities are required under Article 29 of the Solvency II Directive to duly take any such potential effects into account before they take action. So the policy option chosen should not have a more adverse impact on financial stability than the alternative option.

Social Impact

- 2.37. This policy option is not expected to have first-order social impacts.

Policy Issue 2 – Specifying the time period for provision of requested information by the undertaking to the supervisory authority

- 2.38. The preferred option is Option 1: supervisory authorities are able to request information within timeframes set on a case-by-case basis. This option has

been chosen because it allows supervisory authorities to tailor the time period to the information being requested and urgency of the situation. The other options have been disregarded because they limit the supervisory authorities' ability to act in a case-specific manner, and the nature of the information needed cannot always be established in advance.

2.39. The comparison of effects on different stakeholder groups may be summarised as follows:

Undertakings

2.40. Undertakings will be impacted by any lack of consistency in the procedures used to setting, calculating and removing CAO across a single market and across Member States.

2.41. Whilst consistent treatment would ensure clarity of expectations, they may not allow sufficient discretion for supervisory authorities to take decisions tailored to the individual situation of an undertaking, leading to convergence in methodology but in the end divergence in outcomes across undertakings.

Policyholders and beneficiaries

2.42. From the policyholders' perspective it is very important that supervisory authorities are able to calculate and apply any CAO expediently. When time frames for information requests are set on a case-by-case basis, this ensures that no time is lost with the supervisory authority waiting longer than necessary for information needed in taking a decision about a CAO to be provided.

Supervisory Authorities

2.43. The primary objective of Solvency II is policyholder protection. As such anything which fetters the supervisory authority's ability to secure policyholder protection quickly by applying a CAO, if necessary, is undesirable. Given the specific nature of CAO, setting a universal timescale within which information should be provided risks either being too short a time limit for complex requests or providing over-generous timescales for simple requests.

Financial stability

2.44. For the policy on timeframes for information requests no impact on financial stability has been identified.

Social Impact

2.45. This policy option is not expected to have first-order social impacts.