REPORT ON THE USE OF CAPITAL ADD-ONS DURING 2020

European Insurance and Occupational Pensions Authority

#INSURANCE #PENSIONS #SOLVENCYII

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EXECUTIVE SUMMARY

The objective of the capital add-on measure is to ensure that the regulatory capital requirements reflect the risk profile of the solo undertaking or of the insurance group. Therefore, is it important that it is used by national competent authorities (NCAs) when needed and it is important to ensure a high degree of supervisory convergence in its application.

The analysis in this report addresses the capital add-ons set during 2020 to solo undertakings or insurance groups from the 30 European Economic Area (EEA) countries.[1]

The setting of capital add-ons follows the process as described in Article 37 (for solo undertakings) and Article 232 (for groups) of the Solvency II Directive and relevant article of Chapter X of Solvency II Delegated Regulation.

The capital add-ons are set following the supervisory review as follows: (i) in case the risk profile of the undertaking deviates significantly from the assumption underlying the Solvency Capital Requirement (calculated in accordance with the standard formula or internal model); (ii) if any deficiencies on the system of governance that seriously interfere with proper risk management have been identified; (iii) in case the risk profile of the undertaking deviates significantly from the assumptions underlying the matching adjustment, the volatility adjustment or the transitional measures.

Two NCAs that set capital add-ons in the previous years no longer set capital add-ons in 2020. This situation led to a number of capital add-ons set at the end of 2020 even lower than in 2019. In 2020 seven NCAs set capital add-ons to nine solo undertakings, six non-life and three life undertakings

[1] The European Economic Area comprises 27 European Union (EU) countries together with the 3 European Free Trade Association (EFTA) countries of Iceland, Liechtenstein and Norway. The United Kingdom (UK) is not included in this report after the UK Brexit final decision. The UK transition period according to the Withdrawal Agreement ended on 31 December 2020. Following this date, all Union primary and secondary law will no longer apply to the UK, including the Solvency II Directive.

respectively while in 2019, nine NCAs had set capital add-ons to a total of ten solo undertakings including two life, seven non-life undertakings and one composite. [2]

For groups, similarly to 2019[3], no capital add-ons were set during 2020.

Due to the low number of capital add-ons, the weight of capital add-ons imposed on undertakings using the standard formula remains very low overall in 2020; i.e. the relative size of the capital add-ons is less than 0.1% of the total SCR. However, it remains significant when considering the amount at individual level. In total, considering undertakings with capital add-ons using the standard formula, the weight of the capital add-on accounts for 25% of the total SCR of those undertakings in 2020 (38% in 2019), although there is a wide range in its distribution (from 86% to 1%).[4] In all but one case the capital add-on increases the SCR by at least 10%.

With regards to processes, eight NCAs in total, one more than in 2019, formalised their processes to bring greater convergence in the approach. However, it should be noted that only three of these NCAs have set capital add-ons.

It is important to maintain a level playing field regarding the setting of capital add-ons. As a result of the findings of the survey, and with a decreasing number of capital add-ons at already a low level, EIOPA will continue to monitor the usage of capital add-ons and paying particular attention on the proposals made by NCAs on how to make more efficient use of this tool in the future.

[2] In order to enable a better comparison, the data referred to 2019 also excludes the capital add-ons set by the UK in the past.

[3] The situation in 2020 is the same as in 2019, if we consider that in 2019 the only capital add-ons were set in the UK, which is no longer included in this report.

[4] This difference is due to the fact that UK data is no longer included and in addition less NCAs set capital add-ons compared with the last survey.

1. BACKGROUND

1.1. The report on the use of capital add-ons is an Annual Report[5] that EIOPA publishes, in accordance with Article 52(3) of the Directive 2009/138/EC (hereinafter Solvency II Directive)[6], in order to report to the European Parliament, the Council and the Commission the degree of supervisory convergence in the use of capital add-ons between supervisory authorities in different Member States.

1.2. The setting of capital add-ons follows the process as described in Article 37 and 232 of the Solvency II Directive for solo undertakings (life, non-life, reinsurance undertakings or composite) or for the insurance group respectively and relevant article of Chapter X of Solvency II Delegated Regulation.

1.3. It is important that it is used by NCAs when needed and it is also important to ensure a high degree of supervisory convergence.

1.4. The analysis included in the report addresses the capital add-ons set during 2020 to solo undertakings and to the group from the 30 EEA countries.

1.5. Following the supervisory review process, NCAs may in exceptional circumstances (when other measures have failed, are unlikely to succeed or are not feasible) set a capital add-on for a solo undertaking by a decision stating the reasons.

1.6. The term exceptional should be understood in the context of the specific situation of each undertaking rather than in relation to the number of capital add-ons imposed in a specific market.

1.7. That possibility exists only in the following cases:

(a) the supervisory authority concludes that the risk profile of the insurance or reinsurance undertaking deviates significantly from the assumptions underlying the Solvency Capital Requirement (SCR), as calculated using the standard formula (Article 37(1) a of Solvency II);

(b) the supervisory authority concludes that the risk profile of the insurance or reinsurance undertaking deviates significantly from the assumptions underlying the SCR, as calculated using an internal model (Article 37(1) b);

(c) the supervisory authority concludes that the system of governance of an insurance or reinsurance undertaking deviates significantly from the standards laid down in Solvency II

5The 2019 report can be consulted on EIOPA's website here.

6 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).

(Article 37(1) c), that those deviations prevent it from being able to properly identify, measure, monitor, manage and report the risks that it is or could be exposed to and that the application of other measures is in itself unlikely to improve the deficiencies sufficiently within an appropriate timeframe;

(d) the supervisory authority concludes that the risk profile of that undertaking deviates significantly from the assumptions underlying the volatility adjustment, the matching adjustment or transitional measures (Article 37(1) d).

1.8. For groups, the same conditions apply (Article 232).

1.9. The Solvency II Directive requires that the amount of the capital add-on shall be proportionate to the material risks arising from the deficiencies identified or calculated to ensure compliance with Art. 101 (3) in case of significant risk profile deviations and that the capital add-on shall be reviewed at least once a year by the supervisory authority and be removed when the undertaking has remedied the deficiencies which led to its imposition.

2. DATA SOURCES

2.1. The analysis in this report is based on 2020 year end Quantitative Reporting Templates (QRTs) submitted by 2447 solo undertakings and 326 insurance groups from the 30 EEA countries.

2.2. Additionally, EIOPA launched a survey for NCAs that included both qualitative and quantitative questions on the use of capital add-ons.[7]

2.3. With regard to the quantitative section of the survey, information on the number of capital add-ons set per solo undertaking or per group as well as the reason which led to set the capital add-on (information not available in the QRTs) was requested.

2.4. The survey also included qualitative questions on the use of the capital add-ons, focusing on changes in comparison to the last year, to gain a better understanding of the changes in the processes of setting, calculating and reviewing the capital add-ons.

2.5. In this regard, the qualitative section aims to support the understanding of the circumstances where capital add-ons were used in order to contribute to a higher degree of supervisory convergence in the different Member States. Finally, it was requested to comment on possible initiatives and measures which could facilitate and promote the use of the capital add-on.

2.6. The graphs and tables with the number of undertakings and groups used in this report are based on the information obtained from the QRTs complemented with the information collected in the survey.

[7] All but 2 NCAs submitted the survey. These NCAs do not use capital add-ons.

3. CHANGES ON PROCESSES AND POLICIES

3.1. The answers provided by NCAs indicate that the processes implemented some years ago are still valid. [8]

3.2. Hence, this report should be read in comparison to the previous years' reports, which are published on EIOPA's website.

3.3. In 2020, eight NCAs in total, one more than in 2019, formalised their processes to bring greater convergence in their approach. However, at this stage only three of these have set capital add-ons. Moreover, none reported in the survey that they plan to formalise their processes in the years to come.

3.4. However, in line with the previous reports, NCAs have used other supervisory measures such as e.g. calculating the best estimate of technical provisions where divergent practices amongst supervisors exist or increasing or reducing own funds.

3.5. However, some NCAs continue to see the processes to set capital-add-ones as too complex and burdensome. This situation might be the reason why in some member states so called self-imposed capital add-ons were identified, i.e. capital add-ons set voluntary by some undertakings following a dialogue with the NCA.

3.6. This report, as the previous ones, does not include them as they are not qualified as capital add-ons under Solvency II. [9]

3.7. Answering the question on possible improvements, a variety of proposals to facilitate the use of capital add-ons have been identified by some NCAs, namely:

a) EIOPA could add examples of best practices and supervisory tools to help identify the causes that, based on Article 37 a) to d), should lead to capital add-ons;

b) EIOPA could add guidance how to calculate the amount of the capital add-on and provide handbooks, based on the experience of supervisors who set capital add-ons.

[8] For a detailed description of processes used please refer to eiopa_report_capital_add_ons_during_2017_final.pdf (europa.eu)

[9] Detailed information on page 6: https://www.eiopa.europa.eu/content/report-use-capital-add-ons-during-2018_en

3.8. EIOPA takes due note of these improvements identified and will take them into consideration in the discussion of future Supervisory Convergence Plans incorporating other priorities and resources as well.

4. DISCLOSURE

4.1. According to Article 31 of the Solvency II Directive and Article 316 in connection with Annex XXI of the Delegated Regulation, NCAs that set capital add-ons have to disclose in particular the following:

- The number of capital add-ons, the average capital add-on per undertaking and the distribution of capital add-ons measured as a percentage of the SCR, with regard to all insurance and reinsurance undertakings supervised under Directive 2009/138/EC;[10]

- The criteria used for the application of capital add-ons and the criteria for their calculation and removal.[11]

4.2. According to Article 51(2) of the Solvency II Directive, Member States may exercise the option to temporarily limit the public disclosure by each insurance and reinsurance undertaking within their annual Solvency and Financial Condition Report (SFCR) of the capital add-ons set on an annual basis.

4.3. Since December 2020 the information on capital add-ons became obligatory for undertakings and insurance groups on an annual basis on a public basis.[12]

4.4. This means the first SFCRs expected to have information on capital add-ons are the ones addressing the financial year end after end-December 2020, i.e. the SFCRs regarding the end of 2021 and published in 2022 for the majority of the market.

4.5. Checking the SFCRs for December 2020, the following can be observed:

a) Seven of the nine SFCRs have the capital add-on disclosed;

10 Annex XXI – Part A, point 23 of the Solvency II Delegated Regulation.

11 Annex XXI – Part B, point 8 of the Solvency II Delegated Regulation.

12 Indeed the transitional period during which the capital add-on were not needed to be separately disclosed (According to Article 51 (2) of the Solvency II Directive) has ended as of 31 December 2020.

b) One undertaking with a capital add-on did not disclose the capital add-on in the SFCR;

c) One undertaking with a capital add-on did not disclose a SFCR as it is in liquidation.

4.6. EIOPA takes note of this disclosure in 2020 and will follow-up with the respective NCA on any issue identified.

5. NUMBER OF CAPITAL ADD-ONS FOR SOLOS

5.1. The number of capital add-ons remains low for solo undertakings and groups and decreased even further in 2020.

5.2. In 2020, seven NCAs have set capital add-ons to nine solo undertakings, out of 2447 (re)insurance undertakings under the Solvency II Directive in the EEA. These include six non-life undertakings and three life undertakings.

5.3. In 2019, nine NCAs had set capital add-ons for a total of ten solo undertakings including two life undertakings, seven non-life undertakings, and one composite. [13]

5.4. In 2020, two capital add-ons were applied as a result of deficiencies of systems of governance (Article 37 (1) c) and the remaining seven capital add-ons related to the risk's profile deviation from the underlying assumption for the calculation of SCR (Article 37 (1) (a)).

5.5. There were no cases of capital add-ons set as a consequence of risk profile deviations following application of matching adjustment, volatility adjustment or transitional measures (Article 37 (1) (d)) and Article 37 (1) (b) regarding internal models respectively (see Table 1.1).

[13] In order to enable a better comparison, the data referred to 2019 also excludes the capital add-ons set by UK.

TABLE 1.1: CAPITAL ADD-ONS AT SOLO LEVEL IN 2020 (VERSUS 2019)

	Total	Imposed under article 37 (1) a[14]	Imposed under article 37 (1) b[15]	imposed under article 37 (1) c[16]	Imposed under article 37 (1) d[17]
Total	**9 (10)**	**7 (7)**	**0 (0)**	**2 (2)**	**0 (1)**
Life	3 (2)	2 (2)		1 (0)	
Non-life	6 (7)	5 (5)		1 (1)	0 (1)
Reinsurance	0(0)				
Composite	0 (1)			0 (1)	

14 Standard formula significant risk profile deviation

15 Internal model significant risk profile deviation

16 Significant system of governance deviation

17 Significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measure

5.6. The following Table 1.2 provides an overview of the number of capital-add-ons set at solo level in 2020 by country (under all the conditions referred to in Article 37 of the Directive).

TABLE 1.2: CAPITAL ADD-ONS AT SOLO LEVEL IN 2020 BY COUNTRY

	Total capital add-ons 2020 (2019)	Life	Non-life	Reinsurance	Composite
Total	**9 (10)**	**3 (2)**	**6 (7)**	**0 (0)**	**0 (1)**
Cyprus	0 (1)				0 (1)
Denmark	0 (1)		0 (1)		
Finland	1 (1)		1 (1)		
France	1 (2)	1 (1)	0 (1)		
Hungary	1(0)		1(0)		
Ireland	1 (1)		1 (1)		
Italy	2 (1)	1 (0)	1 (1)		
Norway	2 (2)		2 (2)		
Spain	1 (1)	1 (1)			

6. NUMBER OF CAPITAL ADD-ONS FOR GROUPS

6.1. A capital add-on to the consolidated group SCR might be set when the risk profile of the group is not reflected adequately.

6.2. In the EEA countries 326 groups are under supervision according to Solvency II.

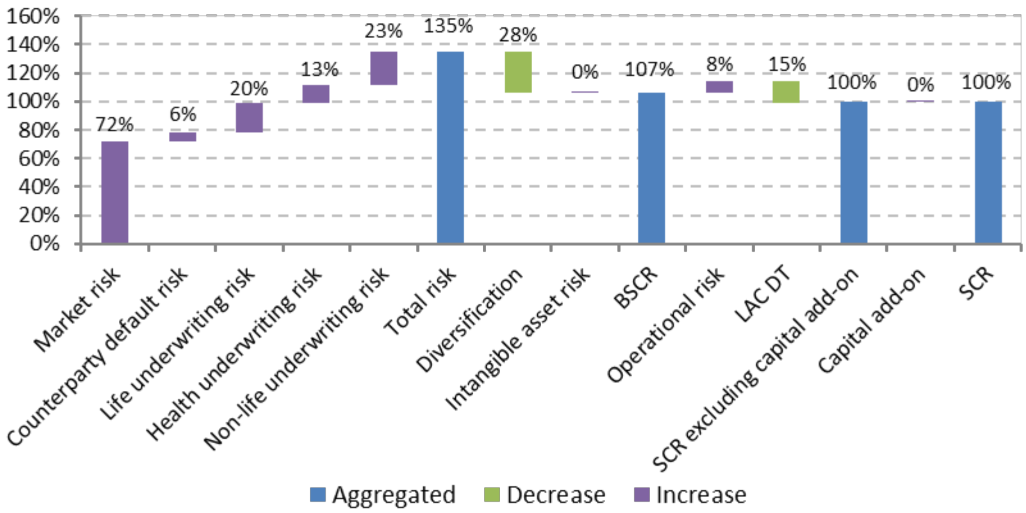
6.3. In 2020, no NCA has set group capital add-ons.

7. AMOUNT OF CAPITAL ADD-ONS

7.1. The size of the capital add-ons applied varies considerably in terms of the amount at individual level.

7.2. Similarly to 2019, the amount to capital add-ons imposed on undertakings using the standard formula remains very low in 2020 amounting to less than 0.1% in 2020 (rounded 0% in both 2020 and 2019) of the total SCR, considering all undertakings using standard formula (Figure 1.1).

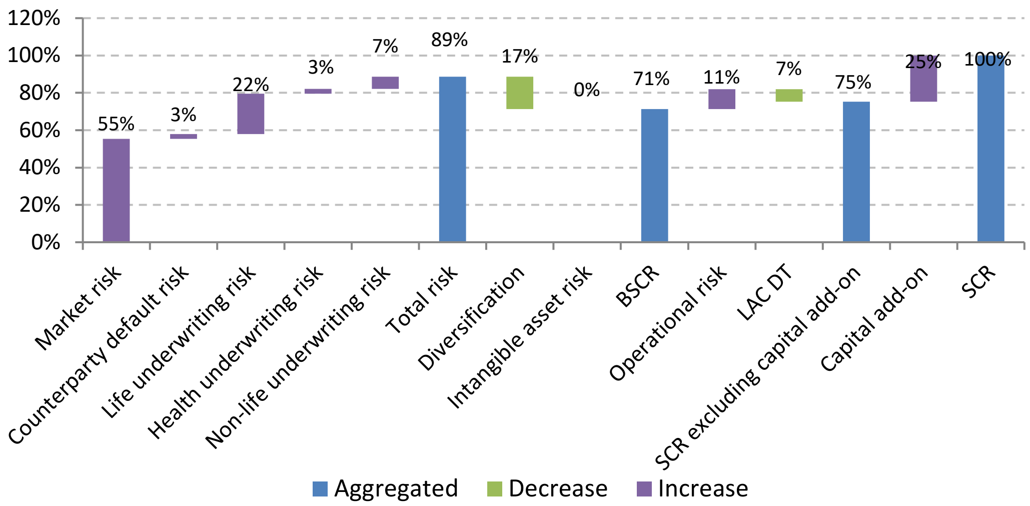
FIGURE 1.1: MAIN COMPONENTS OF SCR FOR ALL UNDERTAKINGS USING THE STANDARD FORMULA IN 2020



7.3. However, when considering the amount at individual level a different picture emerges.

7.4. Indeed, considering those undertakings with capital add-ons using the standard formula, the weight of the capital add-on accounts for 25% in 2020 (38% in 2019) of the total SCR, considering only undertakings that have received capital add-ons (Figure 1.2).

FIGURE 1.2: MAIN COMPONENTS OF SCR FOR INSURERS USING THE STANDARD FORMULA WITH CAPITAL ADD-ON IN 2020

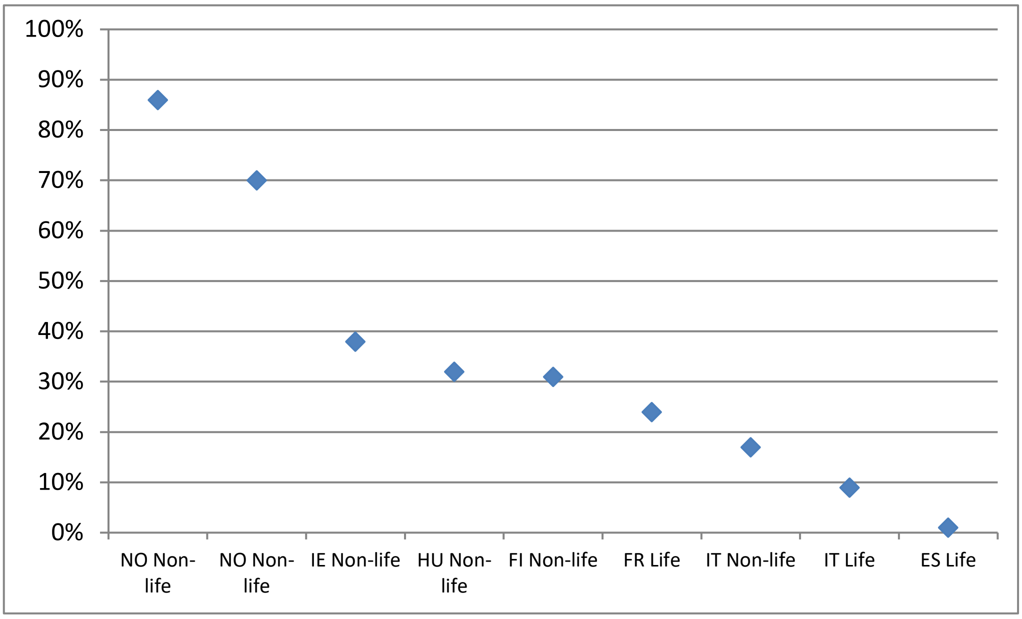


7.5. The distribution of the capital add-ons as a percentage of the total SCR in 2020 for undertakings that imposed capital add-ons varies substantially, as in 2019.

7.6. In 2020, the largest weight is 86% of the SCR (81% in 2019), whereas the smallest weight is 1% of the SCR (0% in 2019).

7.7. In all but one case, the capital add-on increases the SCR by at least 10% (Figure 1.3).

FIGURE 1.3: DISTRIBUTION OF THE INDIVIDUAL CAOS AS A PERCENTAGE OF TOTAL SCR IN 2020 FOR UNDERTAKINGS WITH IMPOSED CAPITAL ADD-ONS



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