FEEDBACK STATEMENT FROM COMMENTS RECEIVED ON THE SUPERVISORY STATEMENT ON SUPERVISION OF RUN-OFF UNDERTAKINGS

28 January 2022

European Insurance and Occupational Pensions Authority

Introduction

EIOPA would like to thank all the participants in the public consultation for their comments on the draft Supervisory statement on supervision of run-off undertakings.

The input received provided important guidance for EIOPA to finalise the Supervisory statement. All of the comments submitted were given careful consideration by EIOPA. The individual comments received and EIOPA's response to them are published as a separate document except those marked explicitly as confidential from stakeholders.

Aim and rationale of the Supervisory statement

The Supervisory statement aims to ensure that a high quality and convergent supervision is applied to run-off undertakings/portfolios, subject to Solvency II, taking into account their specific nature and risks[1] as well as the principle of proportionality and the prudent person principle.

The statement is addressed to the national supervisory authorities and sets out supervisory expectations for the supervision of run-off undertakings in the context of portfolio transfers, acquisitions of qualifying holdings and mergers (ownership changes) as well as in the on-going supervision.

This Supervisory statement should be read in the context of Article 29, 30, 34 and 36 of Solvency II Directive inter alia in conjunction with EIOPA Guidelines on system of governance[2], EIOPA Guidelines on basis risk[3], and Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector[4] as well as EIOPA's Approach to the Supervision of Product Oversight and Governance[5].

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[1] In this context, EIOPA advised European Commission to amend the Solvency II framework with regard to the expenses assumptions considered in the calculation of technical provisions of undertakings not underwriting new business (see section on expenses of the EIOPA's Opinion on the 2020 review of Solvency II).

[2] https://www.eiopa.europa.eu/content/guidelines-system-governance_en

[3] https://www.eiopa.europa.eu/content/guidelines-basis-risk_en

[4] https://esas-joint-committee.europa.eu/Pages/Guidelines/Joint-Guidelines-on-the-prudential-assessment-of-acquisitions-and-increases-of-qualifying-holdings-in-the-banking,-insuranc.aspx

[5] https://www.eiopa.europa.eu/content/eiopa-approach-supervision-product-oversight-and-governance_en

The Supervisory statement does not add any new requirements or create administrative burden. It addresses some issues that are not exclusive to run-off undertakings/portfolios, however, experience has shown that some of them may lead to stronger and more concerning consequences in that context.

In this spirit the guidance included doesn’t preclude the supervisory authorities from triggering a supervisory dialogue with undertakings at any time if it is deemed appropriate considering the risk-based approach.

Main comments received and how EIOPA addressed them

Legal hook

Number of stakeholders expressed doubts regarding the addressee of this supervisory statement due to the reference made also to insurance and reinsurance undertakings within the document.

It is EIOPAs duty to contribute to high quality common supervisory standards and practices in particular by providing statements on the basis of Article 29(2) of Regulation (EU) No 1094/2010.

Altough the document sets supervisory expectations which translate ultimately on undertakings, the Supervisory statement, which is based on Directive 2009/138/EC (Solvency II), is addressed to the competent authorities with the aim to foster supervisory convergence in the area of the supervision of run-off undertakings.

Context and objective

Stakeholders argued that it would be helpful if EIOPA could fully define the scope of “run-off business models” that are intended to be covered by the supervisory statement, for example whether businesses that are closed to new policyholders, but still have the ability for renewals for existing policyholders based on the same terms and conditions are falling in the scope of the Supervisory statement. EIOPA has further highlighted that in the definition of run-off introduced in paragraph 3.1 where a reference note has been added.

Based on comments received from a number of respondents to the consultation paper that the Supervisory statement should avoid treating issues that apply to all companies, regardless of whether they are in run-off or not, EIOPA has highlighted in paragraph 2.5 that, although not exclusive to run-off, experience has shown that some issues may lead to stronger and more concerning consequences in that context.

Definition of run-off

Stakeholders argued that it remains unclear what is meant by "portfolio of contracts" as referred to in paragraph 3.1. EIOPA was asked to clarify whether undertakings with cancelled contracts, which together could be regarded as a portfolio, are subjected to run-off supervision, even if such a portfolio does not constitute an entire line of business. A reference note has been added to clarify that 'portfolio of contracts' is covering also the cases for undertakings with contracts, which together could be regarded as a portfolio, even if such a portfolio does not constitute an entire line of business. EIOPA confirmed that this implies that line of business is not the decisive factor when applying this definition. As mentioned in paragraph 3.2. the definition of partial run-off excludes the cases where a minority of non-material products/line of business is discontinued.

A number of stakeholders commented that EIOPA did not define or describe what 'material' means in the definition partial run-off. EIOPA reiterated that, consistently with other aspects of Solvency II, it is not envisaged to include a specific definition of 'materiality' in addition to the definition included in Commission Delegated Regulation 2015/35, as it depends on the specific risk profile, business model and the complexity of the business run by the particular (re)insurance undertaking.

Decision to go into run-off

Some stakeholders did not question the need for the assessment considered in paragraph 4.1 of the Statement, however they expressed their doubt why EIOPA did not refer in the text also to the need of an ad-hoc ORSA in case undertaking is notifying the supervisor about the decision to go into run-off. Stakeholders argued that such a decision would imply automatically a significant change in the risk profile and as such an ad-hoc ORSA is needed (as indicated in paragraph 6.26). EIOPA clarified in paragraph 4.2 that decision to stop writing any material new business might lead to significant change of the risk profile of the undertaking and consequently trigger an ad-hoc/non regular ORSA but it is not always the case.

A number of stakeholders raised the comment that the decision to stop writing new business should not immediately cause an ad-hoc Solvency and Financial Condition Report (SFCR) because the information needs to be disclosed after conclusion of the contracts in order not to disturb the negotiations concerning these contracts. EIOPA agreed with this comment and made an additional clarification through reference note in paragraph 4.2. 'The paper does not necessarily imply that the ad-hoc SFCR publication is done before the conclusion of the contracts.'

Further comments were made in the context of the fact that the Statement should distinguish between cross-border run-off transfers and run-off of cross-border business without a transfer. Stakeholders are of the opinion that in cases where there are cross-border run-off transfers, both supervisory authorities jointly cooperate. Stakeholders expressed their doubts why a different treatment or additional supervision would be necessary in a normal run off of a portfolio of cross-border business with the undertaking having underwritten the book of business. EIOPA clarified that the Supervisory statement does not require additional supervision in case of run-off of cross-border business without a transfer. However, in case needed, home and host supervisory authorities should cooperate and exchange any information at their disposal which could affect policyholder's right.

<u>Specialised run-off undertakings through acquisition of an insurance undertaking or transfer of portfolio</u>

<u>Early dialogue</u>

The main comment received with regards to this sub-section of the Supervisory statement is related to the external actuarial report required in paragraph 5.2 in case of portfolio transfer and that there are already actuarial and risk reports written by the Key functions (Actuarial Function, Risk Management Function) which could fulfil the analysis as required within the Statement. EIOPA has further clarified that the actuarial and risk reports written by the relevant Key functions are only available some time after the conclusion/approval of the transaction while the purpose of the recommendation is make more efficient the early dialogue among undertakings and the Supervisory authority before the transation is concluded. However, EIOPA has clarified that the external actuarial report is requested only for all portfolio transfers for which undertakings request the authorisation (in accordance with Article 39 of Solvency II Directive) to their supervisory authority.

<u>Identification of the risks of the acquisition/ transfer of portfolio</u>

Some stakeholders argued that the recommendation included within paragraph 5.5, in particular the details required for the in-depth assessment of the risk of the transaction, seems to be applicable only to life business transfers and it does not fit non-life business transfers or reinsurance transfers (life and/or non-life). Stakeholders asked also for a clear distinction between the different types of insurance and reinsurance business throughout the Statement. EIOPA kept the approach to refer generically to risks, in line with the risk-based approach of Solvency II. Therefore the recommendation to assess undertakings' business model, after the transaction, their capital/solvency position, the system of governance, the financial strengths of the group, among the others, are also valid in case of acquisition of non-life run undertakings or portfolios.

Main concern expressed from some stakeholders was the fact that proportionality should be explicitly referred to in the Statement. Their opinion is that for non-life transfers, this statement may go beyond an adequate assessment. EIOPA has responded to this comment that the working assumption for all Supervisory statements issued is that the proportionality principle is considered by default. For the sake of the clarity requested EIOPA has added an explicit reference under paragraph 2.4.

Ongoing supervision - business model analysis and assessment of Technical Provisions

A number of respondents to the public consultation argued that migration to a new, more modern IT system can also reduce Operational risks. This could be the case especially if a large number of older IT systems can be switched off as a result. EIOPA acknowledged that and clarified that the paper is simply highlighting the need for Supervisory assessment / review of these changes when they occur.

Further comments with regards to the Business Model Analysis were provided by stakeholders and in particular in the context of calculation of technical provisions. According to their opinion the technical provisions are calculated based on the business covered and do not change following a undertaking's decision to put in run-off its entire business. They claim this is evidenced by the fact that undertakings going under concern usually do not change their projection methodology at the moment a single contract goes into run off: ie, the moment its term ends. EIOPA didn't agree with this argument as policyholder's might react to the pure decision to put the business in run-off or to accompanying management action (e.g. reducing discretionary profit sharing). Furthermore, a reference was made to Q&A 1037, according to which expense assumptions should be realistic. When the portfolio is put in run-off, the expense projections are expected to no longer consider new business.

A number of respondents of the consultation paper commented on the paragraphs dedicated to reinsurance 6.13 to 6.15 that from practical point of view there will be always a different value of the reinsurance recoverable in the balance sheet of the ceding undertaking compared to that of the accepting reinsurer. They claim this will always be the case because of lack of information, different management rules and diversification effects. EIOPA reinforced its position it is expected that often the reinsurance recoverables of the insurer and the best estimate of the reinsurer should be broadly in line. Furthermore it has been acknowledged, as stated in the text, that circumstances can exist where differences may arise which are economically sound. However, since it has been observed that for some differences go beyond what is reasonable, the Supervisory Authorities should be aware of these cases.

<u>Ongoing supervision - assessment of investment strategy and assessment of reinsurance strategy</u>

Some stakeholders argued that they didn't see the reason why undertakings that underwrite new business should not focus on increasing their investment returns given their risk appetite as referred to in paragraph 6.16 of the Statement. EIOPA responded that all undertakings can focus on increasing their investment returns, however the means to do so often differ from run-off undertakings to those that underwrite new business. In new business the conditions and characteristics of the contract are yet to be defined, while in run-off portfolios they are already agreed. This usually provides a limited profitability which may result in the search for higher investment returns. It was further clarified that this section simply refers to some of the investment strategies that have been implemented in order to seek for higher profits in run-off businesses.

In this context respondents of the public consultation further commented that in case of a run-off, the investment strategy shouldn't necessarily become more complex, moreover synergy effects can be achieved if several portfolios are merged. It has been highlighted by EIOPA that in run-off undertakings, the strategy or structure may not always become more complex. However, in the specific cases that are described in the statement Supervisory Authorities have often identified assets and/or structures that are not typical of most insurance companies, thus making the assessment of these companies more challenging.

On the reinsurance sub-section a number of stakeholders commented that reinsuring a large proportion of risk by itself does not result in an underestimation of the counterparty default (and, where applicable, concentration) risks. It was further noted by them that remoteness in the attachment point does not by itself basis risk. Only in exceptional cases where the counterparty SCR for any structural reason does not adequately reflect the risk, should trigger further steps. EIOPA has reiterated its position that reinsurance indeed doesn't automatically mean a large counterparty or concentration risk, however in the case of 'run-off' it is often observed that the portfolio is reinsured to just one counterparty. In that case it is considered a good practice to assess these risks and if needed address the issue in the ORSA.

Conduct of business supervision

Some respondents of the public consultation claimed that EIOPA should clearly define what specific risks could arise in the context of run-off transfers. According to their opinion all aspects covered in points 7.2 to 7.7 are applicable to every undertaking operating in the market in any type of business. EIOPA agreed that these are risks which could arise in the case of normal business and not just for portfolio transfers, however it was highlighted there are also enhanced risks. EIOPA considers important to ensure that the level of consumer protection offered by the ceding undertaking is not diminished when the portfolio is transferred. Examples of risks which could be enhanced include: less monitoring carried out under product oversight and governance; differing, most lengthy claims handling and complaints handling process. Moreover, in instances of cross-border portfolio transfers there can be risks associated with the fact that the protection offered is diminished (E.g., non-existence of insurance guarantee scheme in the new Member State).