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Report on the use of capital add-ons 2017

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Executive summary

As at year-end 2016, four Member States have imposed a total of 20 capital add-ons at solo undertaking level (UK 15, France 2, Norway 2 and Ireland 1) and one Member State (UK) has imposed a total of 4 capital add-ons at group level.

The larger proportion of capital add-ons in the UK market at solo and group level is indicative of the size and complexity of the UK market. In particular, capital add-ons were imposed to account for specific risks arising in relation to specialty business, complex arrangements with counterparties and risks associated with defined benefit pension schemes that are not adequately reflected in the standard formula calculation.

Capital add-ons at group level have been set when the deviation found at solo level is also material at group level, and the capital add-on set at solo level is not also used for the calculation of the group Solvency Capital Requirement.

Most of the 24 capital add-ons related to cases where the risk profile of the undertaking deviated significantly from the assumptions underlying the Solvency Capital Requirement calculated under the standard formula. In two cases, the add-on was applied when the risk profile of the undertaking deviated significantly from the assumptions underlying the Solvency Capital Requirement calculated under a full or partial internal model.

No capital add-ons were set concerning a significant deviation in system of governance from the regulatory framework or on the basis of a significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measures in Articles 308c or d.

The capital add-ons set, vary from 2% to 85% as part of the total Solvency Capital Requirement.

From a risk management point of view, undertakings' scenario analysis which come available at the level of the national competent authorities (NCAs), can be a useful source of information to do further investigations and assessments for the possible need for a capital add-on. This analysis is expected to evolve in line with the overall implementation of the SCR review process.

A number of undertakings in various Member States are reporting capital add-ons that were not formally imposed by the NCA. Instead the undertakings use the field for late corrections of data and for the use of the so-called 'self-imposed capital add-ons' which represent a reporting error and are not subject of the conclusions of this report.

Twenty-two Member States implemented regulation to make use of the option not to disclose capital add-ons for a transitional period.

Additional finding regarding supervisory convergence:

The fields (R0210/C0100) for reporting capital add-ons in the reporting of QRT template S.25.01 (for undertakings reporting under Standard Formula), S.25.02 (for undertakings reporting under Standard Formula and partial internal model) and S.25.03 (for undertakings reporting under full internal model) are used incorrectly in some cases. The fields are meant for formal capital add-on imposed by the NCA according to Article 37 of the Solvency II Directive and not for so-called 'self-imposed' capital add-ons. Introducing a separate field in the reporting template for late stage corrections of data could be useful.

I. Introduction and mandate

1. Objectives

EIOPA's analysis on the application of the supervisory powers across Member States is meant to inform all stakeholders on their use and to detect and follow-up on potential inconsistent applications.

2. Mandate

According to Article 52 (3) of the Solvency II Directive 2009/138/EC, EIOPA shall provide the information referred to in Article 52 (2) to the European Parliament, the Council and the European Commission, together with a report outlining the degree of supervisory convergence in the use of capital add-ons between supervisory authorities in the different Member States.

According to Article 37 and 232 of the Solvency II Directive 2009/138/EC national competent authorities (NCAs) have the possibility to set capital add-ons for a (re)insurance undertaking or for a group. Following the supervisory review process supervisory authorities may in exceptional circumstances set a capital add-on (CAO) by a decision stating the reasons. That possibility shall exist only in the following cases:

- a. where there has been a standard formula significant risk profile deviation;
- b. where there has been an internal model significant risk profile deviation;
- c. where there has been a significant system of governance deviation;
- d. where there has been a significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measures in Articles 308c or d.

Further relevant legislation is laid down in Article 276 to 287 of the Commission Delegated Regulation (EU) 2015/35 and Commission Implementing Regulation 2015/2012 laying down implementing technical standards with regard to the procedures for decisions to set, calculate and remove capital add-ons.

3. Disclaimer

This analysis is based on the first annual reporting under Solvency II as sent to NCAs and EIOPA.

4. Data collection

EIOPA extracted the relevant information from the Solvency II QRT reporting based on the information submitted in the relevant templates S.25.01, S.25.02 and S.25.03. For each undertaking, the amount of Solvency Capital Requirement has been extracted from the relevant Own Funds template (S.23.01) of the 2016 year-end reporting information. The reporting

information is converted to EUR based on ECB exchange rates at 31/12/2016 where relevant.

II. Process for granting capital add-ons

1. General observations

Based on the answers to the dedicated survey, received from the NCAs from the 28 EU Members and the 3 EEA Members, the following observations can be made:

Six NCAs have put in place a formal policy for setting and reviewing the potential need for a capital add-on, directly related to the process described in article 37 of the Solvency II Directive.

Twenty-one NCAs have no formal policy for assessing the potential need for setting and reviewing a capital add-on but approach this as a process part of the ongoing supervision and as a result of the assessment of the current risk situation of an undertaking. Three NCAs are in the process of writing a formal policy. One NCA has a formal policy which is laid down in the internal procedures as part of the SRP process.

Sixteen NCAs have drafted an internal process to be followed when setting and reviewing a capital add-on based on Article 276-287 of the Commission Delegated Regulation (EU) 2015/35 and the legal provisions from the Commission Implementing Regulation (EU) 2015/2012. Thirteen NCAs have no internal process set (yet). One NCA is in the process of writing a formal internal process and one NCA uses a case-by-case approach.

For thirteen NCAs, the process to impose a capital add-on does not vary according to the risk profile of the undertaking. When the internal process to impose a capital add-on varies, as is the case for eleven NCAs, this is mostly related to the risk profile not being adequately reflected in the standard formula (based on the nature, scale and complexity of the risks inherent in the business of insurance or reinsurance undertaking). Seven NCAs indicated that the question of varying according to the risk profile of the undertaking has not yet arisen.

Furthermore, five NCAs declared that the information from scenario analysis is used as one of the sources of information to do further investigations and assessments for the possible need for a capital add-on.

2. Self-imposed capital add-ons

Undertakings are free to hold additional capital in excess of the capital requirements in amounts as they consider appropriate (and may report in their ORSA as overall solvency needs according to Article 45(1)(a)).

These so-called “self-imposed add-ons” are in fact additional capital buffers included by undertakings and/or groups themselves as remediation to issues that remain unsolved, and not formal capital add-ons which have been imposed by the competent NCA in line with the Solvency II legislation.

Several undertakings have incorrectly reported capital add-ons by the NCA while these are in fact self-imposed capital add-ons and/or late stage corrections of data.

3. Differences across Member States

A number of NCAs only refer to the current legislation but do not have any other (internal) policy and/or processes developed for imposing capital add-ons. Other NCAs have developed own internal policy and process, often laid down in national legislation. The different approaches possibly may lead to divergence in the application of capital add-ons affecting the level playing field across the EEA. Given the relative small size of the number of capital add-ons, no further analysis has been done.

There is a large variance in the amount of the capital add-ons which has been imposed. There are two capital add-ons with an amount of more than € 1 billion, three capital add-ons between € 100 million and € 700 million and all other capital add-ons are below € 100 million. Regarding the relative size of the capital add-ons which has been imposed, the variation is between 2% and 85%

4. College of Supervisors

Three Member States have experience to impose capital add-ons at solo level where the undertaking is part of a cross-border group with a College of Supervisors in place.

The members of the College have been informed about the intention to impose a capital add-on according to the rules and procedures and via the communication channels as described in the Coordination Arrangement of the College of Supervisors.

No disputes within a College of Supervisors regarding capital add-ons have been reported.

5. Capital add-ons at group level

Only the UK NCA has set capital add-ons (4) at group level. It has internal guidance materials that set out the process for capital add-on calculations. This is to ensure that the capital add-on calculations are in compliance with Article 101(3) of Directive 2009/138/EC. Three capital add-ons at group level are related to a standard formula significant risk profile deviation.

6. Capital add-ons related to internal models

One capital add-on set at group level relates to an internal model that did not cover all the material risk profile deviations. One capital add-on, set at solo level, relates to a case where the supervisory authority considered that the risk profile of the ultimate parent undertaking at national level deviates significantly from the internal model approved at group level.

7. Disclosure

According to Article 51 (2) of Directive 2009/138/EC, Member States may provide that, although the total Solvency Capital Requirement is disclosed, the capital add-on or the impact of the specific parameters the insurance or reinsurance undertaking is required to use in accordance with Article 110 need not be separately disclosed during a transitional period ending no later than 31 October 2020. Twenty-two Member States have implemented the option to limit the disclosure of the capital add-on. From those, twenty-one Member States used the option to end the transitional period at 31 December 2020 and one Member State ends the transitional period at 31 December 2017.

III. Quantitative results

1. Capital add-ons imposed on solo undertakings

COUNTRY	Number of capital add-ons	Of which life	Of which non-life	Of which reinsurers	Of which pursuing both life and non-life
EU Total	20	7	10	3	0
France	2	1	1	0	0
Ireland	1	1	0	0	0
Norway	2	0	2	0	0
United Kingdom	15	5	7	3	0

COUNTRY	Number of capital add-ons	Of which imposed under article 37(1)(a)	Of which imposed under article 37(1)(b)	Of which imposed under article 37(1)(c)	Of which imposed under article 37(1)(d)
EU Total	20	19	1	0	0
France	2	2	0	0	0
Ireland	1	1	0	0	0
Norway	2	2	0	0	0
United Kingdom	15	14	1	0	0

article 37(1)(a): standard formula significant risk profile deviation

article 37(1)(b): internal model significant risk profile deviation

article 37(1)(c): significant system of governance deviation

article 37(1)(d): significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measures

2. Capital add-ons imposed on Groups

COUNTRY	Number of capital add-ons	Of which life	Of which non-life	Of which reinsurance
EU Total	4	0	4	0
United Kingdom	4	0	4	0

COUNTRY	Number of capital add-ons	Of which imposed under article 37(1)(a)	Of which imposed under article 37(1)(b)	Of which imposed under article 37(1)(c)	Of which imposed under article 37(1)(d)
EU Total	4	3	1	0	0
United Kingdom	4	3	1	0	0

article 37(1)(a): standard formula significant risk profile deviation

article 37(1)(b): internal model significant risk profile deviation

article 37(1)(c): significant system of governance deviation

article 37(1)(d): significant risk profile deviation following the application of the matching adjustment, volatility adjustment or transitional measures

3. Distribution of capital add-ons

