

Guidelines on the extension of the recovery period in exceptional adverse situations

1. Introduction

- 1.1. According to Article 138(4) of Directive 2009/138/EC of the European Parliament and of the Council (hereinafter Solvency II Directive)¹, supervisory authorities may, under certain circumstances, extend the recovery period for the re-establishment of compliance with the Solvency Capital Requirement (hereinafter SCR) as set out in Article 138(3) and Article 218(4) of the Solvency II Directive by a maximum period of 7 years. This power applies in the event of exceptional adverse situations affecting insurance and reinsurance undertakings representing a significant share of the market or affected lines of business, where undertakings fail to fulfil their SCR. It is vested in supervisory authorities to enable them to mitigate undue potential pro-cyclical effects on the financial system or adverse effects on the financial markets, in particular, on the insurance market that would ultimately be detrimental to the interests of policyholders and beneficiaries.
- 1.2. In order to ensure fair competitive conditions in situations where an extension of the recovery period is a possibility, it is of utmost importance that supervisory authorities develop convergent practices when deciding to whom an extension should be granted and the duration of the extension. According to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council (hereinafter EIOPA Regulation)², EIOPA therefore issues these Guidelines.
- 1.3. These Guidelines are addressed to the supervisory authorities to ensure that they use a consistent approach to the extension of the recovery period in exceptional adverse situations. These Guidelines also address related issues that call for convergent supervisory practices or enhanced harmonisation. These include the withdrawal/revocation of an extension, further extensions of the extension already granted and the disclosure of withdrawals of the extensions.
- 1.4. When EIOPA declares an exceptional adverse situation to exist according to Article 138(4) of the Solvency II Directive this does not automatically mean that any insurance or reinsurance undertaking (hereinafter 'undertakings') from a Member State to which this declaration applies is potentially eligible for an extension of the recovery period.
- 1.5. Out of the three exceptional adverse situations referred to in the second subparagraph of Article 138(4) of the Solvency II Directive, only a fall in financial markets that is unforeseen, sharp and steep will presumably have a major negative impact on most undertakings as this creates an unfavourable business environment. A persistent low interest rate environment is expected to

¹ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p.1)

² Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48)

mainly affect life insurance undertakings, life insurance activities of reinsurance undertakings and some lines of business of non-life insurance undertakings. A high impact catastrophic event may only affect some undertakings to a considerable extent as it will mostly affect certain lines of business.

- 1.6. There are important differences between the above mentioned three exceptional adverse situations with regard to the ability of undertakings to guard against such situations, preventing undertakings from breaching their SCR or recovering from such a breach within the required timeframe. These differences need to be taken into account by the supervisory authority when deciding on whether an undertaking is eligible for an extension and on the duration of the extension.
- 1.7. The power to extend the recovery period is provided for no other reason than to create flexibility with regard to supervisory measures where a significant part of the insurance market faces major problems that could lead to serious repercussions for the market as a whole. These could develop if all players concerned were forced to take similar measures within the same limited time frame, thus creating pro-cyclical effects on the financial system or where important elements of the insurance market are in financial difficulties with detrimental effects on the market.
- 1.8. In deciding on the duration of the extension of the recovery period, supervisory authorities are expected to consider the exceptional character of an extension of the recovery period and the general rule of Article 138(3) of the Solvency II Directive which prescribes that undertakings need to ensure that they put in place the necessary measures to comply with the capital requirements within a limited timeframe of 6 to 9 months.
- 1.9. When the exceptional adverse situation is an unforeseen, sharp and steep fall in financial markets or a persistent low interest rate environment, decisions on the time period for extensions of the recovery period will require supervisory authorities to make assumptions about developments in financial markets. Where those assumptions are shown over time to have been significantly overoptimistic or pessimistic, supervisory authorities need to be able to correct their decisions by either further extending a given extension where expected improvements to the exceptional adverse situation have not materialised or by revoking the extension where obstacles to a quicker recovery are no longer present.
- 1.10. Guidelines 1 to 11 shall apply to individual undertakings and *mutatis mutandis* to groups, i.e. when these Guidelines are applied to groups "undertaking" is to be read as "group" and "supervisory authority" is to be read as "group supervisor".
- 1.11. For the purpose of these Guidelines, the following definitions have been developed:
 - a) "extension of the recovery period" means the extended period to remedy a breach of the SCR, exceeding the original period provided under Article 138(3) of the Solvency II Directive;

- b) "withdrawal of the extension" means the supervisory authority taking back an extension of the recovery period where the undertaking concerned has failed to demonstrate significant progress in remedying the breach of the SCR in accordance with subparagraph five of Article 138(4) of the Solvency II Directive;
- c) "revocation of the extension" means the supervisory authority taking back an extension of the recovery period on account of a material change in the circumstances which were the basis for the extension.

1.12. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.

1.13. The Guidelines shall apply from 1 January 2016.

Guideline 1 – General considerations with regard to the granting of an extension of the recovery period

1.14. The supervisory authority should aim to prevent disproportionate negative effects for the financial market in general or the insurance market in particular when granting an extension of the recovery period and deciding on the duration of that extension. It should ensure that macro-prudential considerations are appropriately balanced against the need to avoid unduly jeopardising the protection of the policyholders and beneficiaries of the undertaking concerned.

Guideline 2 – No extension of the recovery period without the provision that the extension may be reduced or revoked

1.15. The supervisory authority should make all decisions to extend the recovery period subject to the provision whereby the supervisory authority may revoke or reduce the extended recovery period, as appropriate, where the underlying circumstances of the extension have changed in a way that under those new circumstances the supervisory authority would not have granted the extension or would have granted a more limited extension.

1.16. Where EIOPA has declared that the exceptional adverse situation no longer exists, the supervisory authority should review any extension granted as soon as possible.

Guideline 3 - Deciding on the duration of the extension of the recovery period

1.17. The supervisory authority should further extend the extension of the recovery period as appropriate, rather than grant a very long extension of the recovery period from the start.

Guideline 4 – Request for information and recovery plan

- 1.18. The supervisory authority should require the undertaking to provide all relevant information to assist the supervisory authority in assessing the factors and criteria defined in Article 288 c) to h) and in Article 289 of Commission Delegated Regulation (EU) 2015/35³.
- 1.19. With regard to the extension of the recovery period, the recovery plan under Article 142(1) of the Solvency II Directive should include in addition:
- a) a justification of the extension and the proposed duration of the extended recovery period needed in order to address the exceptional adverse situation;
 - b) the progress to be achieved in every three months as a result of the proposed measures and their expected effect on the solvency position.

Guideline 5 - Extension of the recovery period on account of a fall in financial markets which is unforeseen, sharp and steep

- 1.20. Where EIOPA has declared a fall in financial markets which is unforeseen, sharp and steep to exist, the potential pro-cyclical effects should be the decisive factor for the supervisory authority when deciding on the extension of the recovery period and its duration.

Guideline 6 – Extension of the recovery period on account of a persistent low interest rate environment

- 1.21. Where EIOPA has declared a persistent low interest rate environment to exist, the measures taken by the undertaking to limit the deterioration of its solvency position should be the decisive factor for the supervisory authority, when deciding on the extension of the recovery period and its duration.

Guideline 7 – Extension of the recovery period on account of a high impact catastrophic event

- 1.22. Where EIOPA has declared a high impact catastrophic event to have taken place, the decisive factor for the supervisory authority should be the extent to which the undertaking faces claims significantly higher than could have been expected under normal circumstances.

Guideline 8 – Applying a further extension of the recovery period where original assumptions have changed materially

- 1.23. The supervisory authority should only consider a request for a further extension where the underlying circumstances of the original extension of the recovery period have changed in a way that under those new circumstances the

³ Commission Delegated Regulation (EU) No 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.01.2015, p. 1)

supervisory authority could have granted a longer extension of the recovery period and the request is supported by an adapted realistic recovery plan.

- 1.24. The supervisory authority should allow an undertaking to request a further extension of the recovery period as long as the resulting overall extended recovery period does not exceed the maximum period as referred to in Article 138(4) of the Solvency II Directive.

Guideline 9 – Assessing significant progress

- 1.25. When assessing whether the undertaking has made significant progress towards compliance with its SCR as mentioned in the fifth subparagraph of Article 138(4) of the Solvency II Directive, the supervisory authority should determine whether the undertaking is still likely to meet its recovery plan. The supervisory authority should consider at least whether the undertaking:
- a) failed without sufficient justification to implement any measures it has committed itself to take; or
 - b) failed in making significant progress on any of the objectives to be achieved in every three months as a result of the proposed measures that were included in the recovery plan.

Guideline 10 - Withdrawal or revocation of the extension

- 1.26. If the supervisory authority concludes that the extension of the recovery period should be withdrawn or revoked, it should give the undertaking the opportunity to give its view on the proposed withdrawal or revocation within an appropriate timeframe.

Guideline 11 – Public disclosure of the withdrawal or revocation of the extension

- 1.27. Where the supervisory authority withdraws or revokes an extension of the recovery period, it should ensure that the undertaking complies without any delay with the requirement of Article 54(1) of the Solvency II Directive to publicly disclose such information, and the reasons for the withdrawal or revocation, in an update of its Solvency and Financial Condition Report.

Compliance and Reporting Rules

- 1.28. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, competent authorities and financial institutions shall make every effort to comply with guidelines and recommendations.
- 1.29. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.

- 1.30. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
- 1.31. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final Provision on Reviews

- 1.32. The present Guidelines shall be subject to a review by EIOPA.