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Position Paper

Response to consultation paper on EIOPA statement on supervision of run-off undertakings

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Contact person:	Prudential team	E-mail:	prudential@insuranceeurope.eu
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SUMMARY

Overall, the industry welcomes the European Insurance and Occupational Pensions Authority's (EIOPA) efforts to create a level-playing field with the same quality standards for the run-off sector, as this will be helpful for the long-term stability and success of this segment of the market. The industry also supports the strengthening of expertise on run-off businesses, as this will allow for more effective supervision.

The development of this market segment can help the insurance industry through specialisation and freeing-up valuable resources that will help both the investments of the industry in the new challenges and the long-term fulfilment of the obligations with policyholders

A good, adequate capital base of the acquirer is of utmost importance to protect the policyholders covered by the portfolio involved in the transfer. Nevertheless, supervisors should seek to ensure a smooth, fast, adequate process.

In general, the procedures currently in place in the EU allow for transfers at reasonable cost and with a reasonable degree of administrative burden. This should be maintained in order to safeguard the international competitiveness of the European (re-)insurance industry.

As a general remark, a less prescriptive wording should be used across the supervisory statement, since its purpose should NOT be the establishment of additional requirements for supervised entities or supervisors, but rather to promote supervisory convergence regarding existing requirements in regulation.

In addition, more careful wording would be welcome in order to take into account the risk-based approach of supervision under Solvency II.

Insurance Europe aisbl • Rue du Champ de Mars 23, B-1050 Brussels
Tel: +32 2 894 30 00
E-mail: info@insuranceeurope.eu
www.insuranceeurope.eu

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CONTEXT AND OBJECTIVES

2.1. *Run-off business model – when properly and fairly managed – can potentially bring benefits to the insurance market, for instance by making possible to use capital to support more profitable business, enabling cost reduction or orderly exit from the market. It can also be a pre-emptive measure to avoid materialisation of risks with impact on new policyholders.*

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: eg does it cover businesses that are closed to new policyholders, but still have the ability for renewals for existing policyholders based on the same terms and conditions?

The principle-based regulation of Solvency II is suitable for the specific risk profile of a run-off company. Supervision must deal with the respective risk profile, not only for run-off companies.

The benefits of run-off business models are only partially covered in the statement. The industry suggest that EIOPA considers the following amendments, especially for life business:

- High focus and efficiency to improve management of life books.
- Reduce complexity.
- Enable effective investments to modernise life operations, eg IT upgrades.
- Improve long-term stability for policyholders.
- Attract specialised human and material resources.
- Free-up capital and resources on cedant undertakings to invest in key development areas (eg new products, distribution and digitalisation).

2.2. *At the same time, supervision of run-off undertakings/portfolios is particularly challenging because of the specific risk profile, the difficulties of the process and assessment of the change of and the lack of specific regulation on run-off in the Solvency II framework. Understanding the motivation to discontinue the business is also very important.*

Insurance Europe understands the purpose of the supervisory statement is to attempt to ensure consistent supervisory practices by member states' competent authorities (eg Article 29(2) Regulation 1094/2010) and recognises that it is important to build up expertise on all aspects of run-off businesses to ensure that risk is adequately evaluated.

Insurance Europe agrees that it is of great importance to understand the motivation behind the transaction and to ensure adequate capitalisation of the company taking over the risks/portfolio.

As long as the insurer is subject to Solvency II, the normal Solvency II legislation is effective. Creating new obligations for run-off companies, which are not explicitly stated in Solvency II legislation, might result in discriminatory treatment for run-off undertakings compared to other insurance entities. The distinct nature and issues with respect to run-off business should be included in the own risk and solvency assessment (ORSA) and discussed in the supervisory review process if needed.

In addition, the supervisory statement should avoid treating issues that apply to all companies, regardless of whether they are in run-off or not, as issues specific for run-off business models.

Finally, there might be circumstances where the proportionality principle should be applicable in a run-off context. This aspect of supervision of run-off undertakings should be made clear in the statement.

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2.3. *The number and size of run-off portfolios are increasing and a growing interest has been observed from investors in acquiring such portfolios.*

Many European insurers, particularly those with long-term life businesses, trade at a heavy discount to Solvency II own funds, making growth and investments in new developments challenging. Therefore, this is a normal development, due to the synergies and economies of scale with respect to the run-off portfolios. In addition, this could have a positive impact on specialisation and costs both on cedants and acquirers.

2.5. *This Supervisory Statement 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. It addresses some issues that are not exclusive to run-off undertakings/portfolios, however, experience has shown that some issues may lead to stronger and more concerning consequences in that context.*

EIOPA should confirm whether it has analysed experiences providing sufficient insights and justification in order to draw general conclusions, including the absence of the same issues in non run-off portfolios and undertakings. EIOPA should also elaborate further on these experiences and how these translated into actual risks for the general cases of run-off business models.

It should be clarified that every form of portfolio transfer involving portfolios with limited or no new business (local and cross border) are in scope of this supervisory statement. Moreover, it is important to define and differentiate clearly between:

- Non-life insurance companies with run off business.
- Non-life insurance companies in run off.
- Life insurance companies with in force business no longer actively underwritten.
- Life insurance companies in run off (see answers below for details).

In this context it would be reasonable to also highlight the need for a proportionate supervision, as mentioned above. Supervision of run-off business should in this regard not be less flexible than supervision of other business models.

2.6. *This Supervisory Statement should be read inter alia in conjunction with EIOPA Guidelines on system of governance[1], EIOPA Guidelines on basis risk[2], and Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector[3] as well as EIOPA's Approach to the Supervision of Product Oversight and Governance[4].*

[1] https://www.eiopa.europa.eu/content/guidelines-system-governance_en
[2] https://www.eiopa.europa.eu/content/guidelines-basis-risk_en
[3] 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
[4] https://www.eiopa.europa.eu/content/eiopa-approach-supervision-product-oversight-and-governance_en

As part of the context of this Supervisory Statement, a reference should be made to the general principles of supervision in Solvency II. In particular an explicit reference to Article 29 of the Solvency II Directive should be

added, highlighting that supervision shall be based on a prospective and risk-based approach, and should comply with the proportionality principle to ensure that the requirements are applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of an undertaking.

DEFINITION OF RUN-OFF

3.1. *The term "run-off" describes a variety of situations where the insurance undertaking has stopped underwriting new business. The term run-off undertaking may refer to different cases:*

1] *Undertakings running-off a portfolio of contracts not representing their whole business (partial run-off undertakings or undertakings with run-off portfolio);*

2] *Undertakings running-off their whole (previous) business (full run-off undertakings);*

3] *Undertakings with a run-off business model (specialised run-off undertakings).*

As mentioned in section 2.1, the industry would like to see a clear and unambiguous description of a "run-off" undertaking. At the moment it is unclear how EIOPA interprets new business, whether this implies new policyholders or whether this also encompasses renewals. EIOPA should therefore clarify whether it implies that run-off would mean no written premiums, or would written premiums still be possible.

Even in a run-off business situation, policyholders could be required to pay premiums. If this is not possible, EIOPA should then make a distinction between a closed book and a run-off business model. This would imply in the closed book, future written premiums and additional policyholder behaviour would be expected whereas in the run-off business model, there would only be the possibility of cash out flows (with the exception of future discretionary benefits).

It remains unclear what is meant by "portfolio of contracts". EIOPA is 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. And if the line of business should become the decisive factor, EIOPA should clarify what governs the bounds of a line of business.

3.2. *Partial run-off undertakings are undertakings where only part of the business is discontinued while the rest of its business is in going concern. For the purpose of this Supervisory Statement, partial run-off refers to the cases where a material part of the undertaking's business is stopped (i.e. it excludes the cases where a minority of non-material products/line of business is discontinued).*

EIOPA did not define or describe what material means in the definition "partial run-off refers to the cases where a material part of the undertaking's business is stopped". It is therefore assumed that material means that most of the portfolio is in run-off.

As the consultation warns about risks of companies in run-off — such as no new business to cover a potential rise in costs, no proper customer service etc — the consultation only seems relevant when the product offering is decimated.

It is a normal and frequent occurrence that certain products are closed to new business, often due to externally triggered changes (eg changed taxation of products). But the insurer continues to write new business with other/adapted products. It certainly does not make sense for the extensive requirements of this statement to apply in such a case. This case should therefore be explicitly excluded, as the sole reference to materiality is not sufficient. Instead of partial run-off, it is then possible to speak of a full run-off of a partial portfolio.

With regard to non-life, Insurance Europe suggests, in the context of this supervisory statement, that run-off

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be described as "any contract respective contract year (underwriting year) which is not ongoing": ie, the contractual term of which has elapsed. Any such business can be subject to a business transfer.

3.3. *Full run-off undertakings are undertakings with legacy portfolios, typically showing a downward trajectory in terms of technical provisions and the own funds and Solvency Capital Requirement (SCR). Not issuing new insurance policies means that the profitability of the business comes only from the management of the existing business[1]. This business model is generally associated with an active management of the technical provisions, cost reduction measures and/or altering the investment portfolio in a 'search for yield'. This could be also done in cooperation with external parties, ranging from consulting to outsourcing activities to spinning off operating activities.*

[1] Run-off undertakings can change the underwriting and/or investment assumptions, initially considered at the inception of the contract (i.e. profit test), if and to the extent that there is margin for keeping the contracts profitable.

The industry does not agree with the statement that a "search for yield" is directly associated with the active management of these run-off portfolios. Also for this part of the business, the normal Solvency II requirements are in place, such as the prudent person principle, asset liability matching (ALM) etc.

Moreover, the management tools set out are not exclusively used for run-off portfolios and are in fact widely used by insurers.

3.4. *Specialised run-off undertakings are undertakings or groups whose business model is to actively acquire legacy portfolios or undertakings in run-off. Besides the measures taken by full run-off undertakings they seek to realise scale efficiencies by maintaining or increasing the size of their run-off book.*

While this is true, a caveat may be in order, as many of the specialized non-life run off undertakings keep their underwriting license: eg by renewing just a handful of policies. At the same time, there are (re)insurance companies seeking to actively acquire legacy portfolios or undertakings in run off in addition to their usual activities, which are not to be considered as "specialised run off undertakings".

3.5. *This Supervisory Statement addresses risks related to all the three cases above, while recognising at the same time the difference between them.*

As noted above, the statement should clearly differentiate between life and non-life business.

DECISION TO GO INTO RUN-OFF

4.1 *Undertakings which intend to stop writing any material new business, leading to partial or full run-off undertakings, are expected to notify their supervisory authorities (as part of the on-going dialogue) by submitting:*

- *the decision of the administrative, management or supervisory body (AMSB) to run-off their part/whole business including the motivation for putting the business into run-off;*
- *the description of their strategy to manage their remaining business, if applicable, including how products will be monitored and reviewed, and how adequate customer service will be maintained;*

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- *the financial projections of their assets, technical provisions, own funds and capital requirements, including the description of the underlying assumptions (in particular technical provisions) and – where appropriate – appropriate scenario and stress tests;*
- *the material reinsurance and outsourcing arrangements expected in the future;*
- *impact, if any, with regard to key staff retention;*
- *impact, if any, on costs and charges for existing policyholders belonging to the run-off portfolio.*

While the industry does not question the need for the requested information, it is unclear why EIOPA is not referring to the need for an ad-hoc ORSA if these decisions are made. As such a decision would imply a significant change in the risk profile for which an ad-hoc ORSA is needed (as represented in section 6.26). Therefore adhering to the requirements of an ad hoc ORSA is deemed the right course of action.

Moreover, no legal notification requirement applies. Though EIOPA is using the term "expected", the subsequent enumeration of extensive information to be submitted may suggest a reference to a legal requirement.

4.2 *The decision to stop writing any material new business is considered material information and therefore needs to be reflected in the Solvency and financial condition report. If taken in between publications, such an event should also be considered a major development affecting significantly the relevance of the information disclosed and should trigger an up-date of the Solvency and financial condition report.*

The industry agrees that the information to stop writing new business is material. But it does not think that this should immediately cause an ad-hoc Solvency and Financial Condition Report (SFCR) because the information should be spread after conclusion of the contracts (sale, purchase, outsourcing, service level agreement). An earlier information would disturb the negotiations concerning the contracts.

4.3 *In case of cross-border run-off, home and host NCAs should cooperate and exchange any information at their disposal which could affect policy holders' rights.*

The statement should distinguish between cross-border run-off transfers and run-off of cross-border business without a transfer. In cases where there are cross-border run-off transfers, both supervisory authorities jointly cooperate. On the other hand, in a normal run off of a portfolio of cross-border business with the company having underwritten the book of business, it is not clear why a different treatment or additional supervision would be necessary

4.4 *In case of cross-border run-off, specific areas of potential risk are for example, partial knowledge of the products and market trends, communication with the new insurer or reinsurer, lower power of the customers to submit claims. Moreover, when specific consumer protection obligations (e.g. ongoing disclosure requirements or complaints handling) are a competence of the host supervisory authorities with specific national requirements, the host supervisory authorities should contribute to the assessment of whether the acquiring/accepting undertaking is compliant with these requirements.*

The need for increased protection might exist with a cross border transfer of an insurance company, but it is already acknowledged by requesting an appropriate contact for the policyholders. With regard to reinsurance transfers, which are by nature in most cases cross-border transactions, there is no need for additional protective actions, as all parties are sophisticated participants of the market and no consumer needs to be protected.

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SPECIALISED RUN-OFF UNDERTAKINGS THROUGH ACQUISITION OF AN INSURANCE UNDERTAKING OR TRANSFER OF PORTFOLIO

Early dialogue

> **5.2** *The potential acquirer/accepting undertaking is encouraged to have an early dialogue with the supervisory authority before submission of the formal notification on the acquisition of a qualifying holding or on the transfer of portfolio in accordance with Article 57 or with Article 39 of Solvency II respectively. The undertaking intending to acquire a run-off portfolio is encouraged to provide the supervisory authority the information defined in point 4.1 as well as an external actuarial report assessing the adequacy of technical provisions related to the portfolio transfer.*

Concerning the mentioned external actuarial report, the industry would like to emphasize that there are already actuarial and risk reports written by the key functions (AF, RMF) within companies which could fulfil such required analysis. Additionally, actuarial reports would comply with relevant standards of the actuarial profession. Such standards require appropriate levels of documentation to enable third party experts to come up with their own judgment.

Due diligence on portfolios or undertakings may not include a buyer's actuarial report in the terms expressed above and this report may not be available before signing an acquisition. The underwriting risk is addressed by a combination of other due diligence findings and risk assessments, representations, guarantees, price adjustments and indemnities that are particular to every deal. The obligation of such a report is not present in the regulation and certainly not applied to any other type of acquisitions and should not be included here as it prevents normal market functioning.

Identification of the risks of the acquisition / transfer of portfolio

> **5.4** *In order to perform an in-depth analysis of the proposed transaction supervisory authorities are recommended to assess in detail the documentation received as a first step and request the undertaking any further information deemed necessary.*

GENERAL COMMENT ON THIS SECTION: As a general comment for this section (points 5.4 to 5.12) there is nothing in them that should not be included in every transaction in the insurance market.

Not only is it important to have a dedicated team with adequate expertise looking at the transactions, but it also needs to be ensured that the assessment and the full process do not exceed a given time limit (for example 6-12 months) to ensure that the data provided is not outdated. Moreover, with run off portfolios having become increasingly commoditised, the duration of the supervisory process is a necessary precondition for the development of a run-off market in a given jurisdiction

> **5.5** *To perform an in-depth assessment of the risk of the transaction it is vital to assess the financial soundness of the acquiring/accepting entity and the impact on policyholders from both the ceding and the acquiring/accepting undertaking. For an appropriate assessment, supervisory authorities need to develop a comprehensive understanding of the business model pursued by the acquiring/accepting party and the expected changes on its risk profile, system of governance – including product oversight and governance – risk management and solvency position (both SCR and own funds) after the acquisition. This is also relevant*

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when the acquirer of the undertaking is identified as an insurance holding company and is subject to group supervision according to Solvency II[1]. The economic situation of the undertaking is usually strongly dependent on the financial strength of the group and its ability to provide support in the event of a loss. For example, when an external run-off is pursued existing intra-group transactions such as outsourcing contracts, profit-and-loss transfer agreements, reinsurance and subordinated loans are usually terminated.

[1] Holding companies whose main business is to acquire and hold participations in subsidiary undertakings which are exclusively or mainly insurance undertakings.

The description seems to be applicable only to life business transfers by an insurance company. It does not fit the circumstances and requirements of non-life business transfers or reinsurance transfers (life and/or non-life). A clear distinction between the different types of insurance and reinsurance business is required throughout the paper.

5.6 *The protection of policyholders should be one of the main objectives of the assessment and it should not be impaired by the transaction. It is an important issue in case of ownership changes, as the supervisory authority has to assess whether the undertaking will be able to comply with the prudential requirements laid down in Article 59(1)(d) of Solvency II.*

While Insurance Europe agrees with the first part of the statement, it understands this applies to primary insurance business only and thus not to reinsurance. It should be made clear in the entire statement if paragraphs refer to insurance and/or reinsurance business, life and/or non-life business and transfers/M&A transactions.

5.9 *It is also important to assess whether the acquiring/accepting insurance undertaking's product oversight and governance policy has adequate system and controls aimed at mitigating possible risks which can emerge for the 'acquired'/'accepted' target market, taking into account the product characteristics of the acquired portfolio. If needed, the acquiring/accepting undertaking should have its own product oversight and governance policy adjusted and aligned with the acquired/accepted portfolio. It should also carry out the product monitoring and review as part of the product oversight and governance process for the acquired/accepted portfolio.*

Proportionality must be taken into account. At least for non-life transfers, this statement may go beyond an adequate assessment, especially as the portfolio might be only one of many taken over.

5.10 *From an operational perspective, supervisory authorities should pay attention to the ability to service the liabilities, in particular the long-term ones, and the capacity of administration of the policies, which usually requires sophisticated contract management systems. In addition, supervisory authorities should assess how the undertaking ensures that claims will be settled in accordance with the contract terms. Especially for with-profit-business, supervisory authorities should ensure that the policyholders' share (i.e. future discretionary benefits) will not be unreasonably reduced and are broadly in line with the previous policy of the ceding undertaking and the reasonable policyholder expectations.*

The two aforementioned principles ("not unreasonably reduced" and "broadly in line with the previous policy") for future benefits are acceptable and appropriate, but also sufficient. The latter principle ("reasonable policyholder expectations"), on the other hand, creates more confusion than clarity and is also superfluous in view of the other two principles. This principle should therefore be omitted. The concept of "reasonable policyholder expectations‟ is generally unsuitable and dates back to times when a "rational investor" was

assumed. With "normal investors", who are influenced by their own biases and make cognitive errors, the concept of "reasonable policyholder expectations" makes no sense anymore.

Additionally, it should be clarified that discretionary benefits depend on the financial situation of the company and not run-off vs new business. In special cases it could be necessary to reduce or increase discretionary benefits compared to the prior situation. It depends, not only on the financial situation of the company, but also on exogenous factors such as the general market conditions.

Finally, this paragraph only applies to life and only to insurance business transfers. The statement should clearly distinguish this and state what type of business it is referring to in its paragraphs.

5.11 *Supervisory authorities should also ensure, in particular for long-term products, that the acquiring /accepting undertaking, throughout the lifetime of the acquired/accepted portfolio, has the ability to take remedial measures when as part of the monitoring process it emerges that a certain product's main features (e.g. risk coverage or guarantees being materially impacted) cause detriment to the policyholders.*

The industry interprets this sentence as meaning that, for example, if the contractually agreed guarantees can no longer be fulfilled, the acquiring/accepting undertaking must be able to take remedial measures.

Since this statement refers exceptional cases in which the situation of policyholders is improved after the run off, these cases should be specified precisely. The industry therefore recommends that the "eg" in the parentheses should be replaced by "ie".

Involvement of private equity or similar investment entities

5.12 *Private equity or similar investment entities are developing a growing interest in acquiring run-off undertakings. Since their investment horizon is usually shorter than more traditional shareholders, there is a risk that capital is pulled out of the target undertaking with potential negative impact on policyholders protection. To prevent this, supervisory authorities should consider the track record of the involved private equity party and assess the possible consequences of an early withdrawal from the investment. In the case of undertakings providing financial guarantees, investors should not be privileged with regards to profit and losses in the near future to the detriment of policyholders with longer contract terms.*

With acquiring a run off undertaking, a private equity fund or similar investment becomes — at least in part — an owner of the undertaking and is bound to keep the undertaking capitalised sufficiently in line with the general capitalisation requirements at all times. Consequently, there is no need for differentiation based on the structure of the undertaking's owners. Exceptions where problems have arisen should not be generalised in this statement. Furthermore, for a balanced view, this paragraph should also include reference to the potential advantages of run-off in 2.1.

It would be logical for private equity parties to assess whether they are able and willing to continue to manage the business and safeguard the interest of the policyholders throughout the portfolio roll-out. However, investment horizon or dividend policy should not be put in conflict with policyholder protection. Any change of control is subject to regulatory approval and any dividend policy is subject to compliance with Solvency II regulation.

5.13 *From an operational perspective, private equity tends to increase shareholder returns by making changes to the undertaking's operations potentially in four main areas:*

a. changes in the asset allocation to increase the investment returns;
b. operational changes in order to reduce the cost base of the undertaking;

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c. changing the methodology and/or certain underlying assumptions for the valuation of technical provision;
d. *changing the methodology and/or certain underlying assumptions for the calculation of capital requirements.*

General comment: There is nothing in points 5.13 to 5.17 that should not be part of usual supervision of any undertaking.

This paragraph should also mention that a private equity investor can seek to increase their return on investment by reducing costs and more efficient management. Apart from that, an increase of investment returns may also benefit policyholders in case of profit-sharing contracts.

These management tools are not exclusive of private equity investors and many insurers are pursuing profitability enhancement programs that include some or all of those.

5.14 *Private equity investors may seek to increase the return on their investments and thus supervisory authorities should consider the followings:*

- *if policies with profit-sharing are affected, supervisory authorities should assess if the transaction leads to an unbalanced distribution of risk and reward. To assess whether there is such an imbalance, supervisory authorities can ask the investor to provide expected risk-adjusted return figures of the transaction. In any case, there should be neither erosion of the undertakings' substance and earning power nor an erosion of policyholders returns for with profit participation business or an increase in any 'undue' costs charged to policyholders;*
- *if leverage is used to finance the acquisition, the acquirer is to show its ability to serve the debt or refinance any remaining amount at maturity even under unfavourable economic conditions (e.g. by reverse stress tests).*

Solvency II already provides for a risk-based capital requirement which provides a high degree of policyholder protection. In this respect, there is a certain bias in the first bullet of the statement, as it seems to suggest that contractual agreements with clients are not going to be respected.

5.16 *Private equity investor may be able to reduce fixed costs by realizing some efficiencies in the operational processes, acquiring/accepting other run-off portfolios/undertakings or making extensive use of outsourcing arrangements. The supervisory authority should assess:*

- *Whether the private equity investor estimates a minimum amount of fixed costs which are needed to running any undertaking (above all when the size of portfolio is small and doesn't allow to spread fixed costs over a large amount of policies);*
- *The return on investments are higher than costs;*
- *In case of outsourcing, the private equity investor can demonstrate that they are able to manage and oversee the activity of service provider(s) and the extensive use of outsourcing doesn't lead to new major operational challenges or risks.*

The reference to "private equity investors" is not understood when these requirements apply to all types of investors. The outsourcing regime is already covered by the requirements for outsourced activities in other guidelines and regulations. The industry does not see any specific difference for private equity.

As a general comment: Points 5.13 to 5.17 apply to all undertakings and are not specific to run-off business.

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5.18 *Furthermore, experience has shown that legacy platforms backed by private equity are often embedded in complex group structures making it difficult for the supervisory authority to gauge the impact of power shifts and changes in the outsourcing environment. In some cases, ownership changes extends to more than one entity, even from other countries or financial sectors, so it may be necessary to consult with several authorities.*

While this may be true for legacy platforms, this may be a broader trend and a reaction to changing legal environments not intimately connected with the nature of the runoff market.

5.19 *With regard to dividend and coupon payments, the supervisory authority needs to carefully examine the funding structures involved to improve the predicted return on equity (RoE) and the time horizon in relation the RoE. Furthermore, the return expectations communicated to the investors need to be realistic.*

Section 5.20 should be removed because it will be a requirement that goes beyond the requirements of the current legal framework and discriminates against other type of investors.

ON-GOING SUPERVISION

6.1 *This section may be also relevant for the assessment reported on the previous sections.*

The industry agrees to the overall observations in this section. Some run-off undertakings deliver special and beneficial solutions for the overall cost topics.

Overall, it should be made clear that all companies are regulated by the same requirements.

Business model analysis

6.2 *In order to perform a proper risk based supervision and in addition to the assessment conducted prior the decision to go into run-off (section 4) and the business model analysis done in case of acquisition of a run-off undertaking/portfolio (section 5) supervisory authorities should perform a business model analysis as part of the on-going supervision[1]. In this analysis there should be a specific focus on how the undertaking is expected to remain profitable in the near future, whilst also ensuring the compliance with Solvency II rules relating to technical provisions/SCR and the fair treatment of policyholders. It should be also looked at which are the main sources of current and expected profitability (e.g. the assumption used in the calculation of the technical provisions, the possible change of the investments and reinsurance strategy, the improvement of efficiency of the management of the business, through reduction of costs, outsourcing, etc).*

[1] The ex-post business mode analysis should be conducted following a risk-based approach. For instance, if supervisors had already assessed the business model of the undertaking intending to acquire a run-off undertaking or portfolio, it is not expected to conduct a full business model analysis if the risk profile hasn't changed.

The industry would expect this to be part of the "normal" supervisory review process and the assessment of documents such as the ORSA, Regular Supervisory Report (RSR - section A and C).

6.3 *Generally, the focus of a non-life run-off undertaking will be on the claims provisions, by handling the claims in a more 'efficient and effective' way to increase the technical profit (underwriting results). Efficiency, however, should not lead to the unfair treatment of policyholders.*

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The industry would like to mention that the (re)insurance industry as a whole is committed to provide cover for the (re) insured business. A more efficient handling of claims does not necessarily have negative effects. It could also reduce administration costs and thus increase discretionary benefits.

6.5 *From an operational perspective undertakings might try to save costs through a more effective management in the form of modern IT systems, outsourcing, etc. Supervisory authorities should assess if the methods/approaches used to reduce costs do not raise other risks. By way of example, the migration of insurance contracts to a new IT platform and other administrative changes can significantly increase operational risks, which should be reflected in the ORSA.*

The description concerning IT platform does not cover all aspects. Migration to a new, more modern IT system can also reduce operational risks, especially if a large number of older IT systems can be switched off as a result. Obsolescence is a risk and keeping old systems for closed business is a source of higher fixed costs that will negatively impact the undertaking over the long term.

This is a situation that can happen in both companies in run-off and others, which is quite subjective and goes beyond the requirements of the regulations.

Again, references made to the business model are not particular to run-off portfolios/undertakings.

Assessment of technical provisions

6.6 *According to Article 7 of Commission Delegated Regulation (EU) 2015/35[1] (Delegated Regulation) insurance and reinsurance undertakings are required to value assets and liabilities based on the assumption that the undertaking will pursue its business as a going concern. It is important to point out that also undertakings in run-off fall under this definition if they continue to settle their claims. However, the decision to discontinue (parts of) the insurance business may be associated with a change of the financial and non-financial assumptions of technical provisions calculation. If insufficient evidence is shown and the supervisory authority concludes that the technical provisions underestimate the future obligations, the supervisory authority should ultimately consider using the power under Article 85 of Solvency II and require an increase of technical provisions or, in case of deviation of the risk profile, to set a capital add-on in accordance with Article 37 of Solvency II.*

[1] Comission Delegated Regulation (EU) 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, 17.1.2015, p. 1).

The technical provisions are calculated based on the business covered and do not change following a company's decision to run off its entire business. This is evidenced by the fact that undertakings under going concern do not change their projection methodology the moment a single contract goes into run off: ie, the moment its term ends. This is true for insurance policies as well as for reinsurance contracts.

Expenses

6.8 *Undertakings writing new business can offset their cost loading per policy through new business[1]. However, this will usually not be possible in case of run-off undertakings because there will be no new business[2]; at the same time, the business reduction might also imply a reduction of some expenses but*

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also the increase of other expenses related to business reduction (e.g. severance payments). The off-setting of cost may be possible for specialised run-off undertaking that will have new business via portfolio transfers or acquisitions, even if specific assumptions should be required in this case (e.g. consider the possibility that they may not be able to acquire new portfolios). It is important that supervisory authorities make sure that the "non-scalability" is properly addressed in the calculation of the technical provisions.

[1] A common practice is to model the (nominal) costs per policy as a fixed percentage of premiums or a fixed percentage of benefits in case of single premiums (as is for instance the case with direct annuities).

[2] Going concern principle does not require to assume new business will be written in the future. Assumptions should always be realistic, which includes the cases where the undertaking is no longer writing new business. For more details, please see EIOPA Q&A 1037.

For run-off undertakings expenses and their management are very important. Costs per policy will be reduced concerning existing IT systems which produce only low current expenses. The life-time-cycle of IT systems (renewing the systems) should be analysed. This could lead to a reduction of administration costs through full time equivalent (FTE) reduction or by keeping the administration costs constant. The costs of renewing IT systems should be considered and balanced with the reduction of personnel costs.

Also, run-off undertakings, as part of group structure where the main carrier still underwrites new business, will also lead to scalability of costs via an appropriate cost allocation.

6.9 *This may require envisaging future management actions beyond the expenses framework. For example, at a certain point in time it may not be economically viable to continue the business operation any longer with respect to the overwhelming fixed costs. Undertakings need to provide adequate justification on how this is reflected in the calculation of the technical provisions. Whether the projection horizon can be cut off at this point depends on realistic management actions regarding the transfer of the remaining obligations.*

There are some aspects which mitigate the fix the cost problem, especially in the case of life insurance:

- The problem typically does not arise in the initial decades, and so adequate management actions can be foreseen.
- Then, the portfolio may be transferred to a run-off platform or to a third-party administrator. The development of this market will ultimately lead to specialised firms that are able to achieve sufficient economies of scale and ready to acquire suboptimal portfolios/undertakers.
- The problem should not be expected to materialise if the run-off undertaking belongs to a group because in this case the problem can be tackled via group internal outsourcing.

Lapse

6.10 *While in principle run-off undertakings are expected to have an interest in maintaining their existing contracts[1], certain run-off undertakings may try, as part of their business model, to advise policyholders to lapse or cancel their policy. Supervisory authorities should assess and detect such cases and ensure that undertakings treat their policyholders fairly and are acting in their best interest. In particular, supervisory authorities should ensure that if lapses/switches from one product to another occur, this is done in the best interest of policyholders and not to generate higher fees and/or to shift policyholders from products with guarantees to products where they are more exposed to market shocks. In assessing whether policyholders have been treated fairly, supervisory authorities should examine whether the new*

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product towards which policyholders are directed are aligned with their characteristics, needs, and objectives and assess whether the existing policyholders fit within the target market for the new products.

[1] To keep their reputation high, not to lose cost advantages and not to face liquidity outflows.

The switch to products with lower guarantees is addressed here in a one-sided negative manner. A change can also be positive for the policyholder if the guarantee severely restricts a better performance of the capital investment and significantly better returns are in prospect with moderately higher risks. The change in the risk-return profile is therefore not disadvantageous per se.

Moreover, it should be noted that this paragraph only applies to life in-force business. Run-off business in non-life cannot be cancelled as the contractual policy periods are already finished.

6.11 *Furthermore, supervisory authorities should assess whether the risk of higher surrenders or lapses caused by loss of reputation is reflected in the calculation of technical provisions.*

Experience from the German life market has not shown an increase of surrenders for run-off portfolios.

The statement on losses of reputation is not based on actual experience and there is no empiric evidence on how reputation, which is a subjective concept, would impact lapses. The acquirer may have a better, equal or worse reputation than the seller and this will be always difficult to evaluate on an objective basis. The use of this concept for the calculation of technical provisions is dangerous and goes beyond what the Solvency II legal framework states.

Either the sentence should be removed or at least amended as follows:
"Furthermore, supervisory authorities should assess whether the risk of higher surrenders or lapses, **where relevant**~~, caused by loss of reputation~~ is reflected in the calculation of technical provisions".

Reinsurance recoverables

6.13 *The impact of the cession of some insurance risks to the reinsurer will be accounted for in the Solvency II balance sheet of the ceding undertaking under reinsurance recoverables. It should be ensured by the supervisory authority that the assumptions underlying the recoverables are not overly optimistic and are in line with Article 81 of Solvency II and Articles 41 and 42 of the Delegated Regulation. If both the ceding undertaking and the accepting reinsurer are subject to Solvency II, it is expected that the reinsurance recoverables in the balance sheet of the ceding undertaking (before accounting for expected losses due to default of the counterparty) are broadly in line with the gross technical provisions (referred to the same obligations) in the balance sheet of the accepting reinsurer. It should be noted that the differences can be larger in some cases such as if the ceded business becomes part of a much larger homogeneous risk group e.g. for non-life.*

It is important to acknowledge here that, in most EU jurisdictions, reinsurance does not novate automatically to the transferee along with the transferring business to the benefit of which it inures. There are exceptions (eg on application in the UK, Ireland, Belgium), but the general rule is that the insurance business transfers without its reinsurance protection. It is of utmost importance that the company acquiring the portfolio:

- Is financially sound enough to take on the portfolio without any reinsurance on the balance sheet; or
- Has adequate (new) reinsurance protection in place; or
- Agrees with the reinsurer to novate the reinsurance along with the transferring policies/risks.

There could be a variety of reasons why the reinsurance recoverables in the balance sheet of the ceding undertaking are not in line with the gross technical provisions of the accepting reinsurer. For example, in non-life, the gross technical provisions shall never be less than the cedent's reinsurance recoverables, unless there is a dispute over the coverage. The fact that the differences might be larger in some cases may have to do with perfectly reasonable economic explanations (eg risk diversification; different valuation methodologies applied which could vary depending on the nature and relative materiality of the business lines and granularity at which the best estimate liabilities are calculated; different assumptions about the emergence of future experience (the reinsurer may have a broader portfolio on which to base assumptions); a different level of granularity at which assumptions are set given the relative sizes of the portfolios, different expense bases etc). These differences ought not to call into question the reasonableness of the reinsurance arrangements.

6.14 *The reinsurance recoverables typically are based on probability weighted cash flows assuming scenarios with and without the reinsurer's default. The cash flows under the scenario of a reinsurer default will be determined by the insolvency legislation the reinsurer is subject to, which is used to determine the recovery value. In case of a third country reinsurance undertaking, it is possible that the valuation of the recovery value is materially different from a valuation under the insolvency legislation the ceding undertaking is subject to. The assumed credit loss might therefore be lower than the actual loss due to these legal valuation differences before considering economic losses resulting from the defaulted reinsurer not having sufficient funds to reimburse the cedent. The supervisory authority should ensure that this additional credit risk resulting from valuation differences is accounted for in the assumption used to calculate the reinsurance recoverables (e.g. in the Exposure-at-Default and Loss-Given-Default assumptions).*

The first sentence in the above paragraph should be more specific, referring to the regulatory framework in place rather than the generic comment on what is deemed typical practice: ie "Article 42 of the Solvency II delegated act specifies how adjustments to take into account losses due to default of a counterparty shall be calculated as the expected present value of the change in cash flows underlying the amounts recoverable from that counterparty if the counterparty defaults". While an economic portrayal of cash flows is certainly warranted, it cannot be reasonable to require all companies to have an intimate knowledge of the insolvency legislation of all of their reinsurers' jurisdictions. This should be reserved only for those cases where a very material counterparty risk concentration exists vis-à-vis either one or very few reinsurers, and where there is also reason to believe that such a risk concentration is not already appropriately accounted for in the counterparty default risk SCR. Apart from these exceptional cases, the Solvency II standard formula capital requirements under the counterparty default risk must be deemed adequate and sufficient for the prudential assessment of this risk. In fact, such a rule could even have the unintended effect of discouraging cedents from purchasing reinsurance from third-country reinsurers, thereby decreasing the size of their reinsurance panel and increasing their counterparty default risk. This would also not be in policyholders' interests.

6.15 *Typically, the reinsurance recoverable is settled on a recurring basis based on the immediate past financial result or cash flow in a backward-looking manner considering the characteristics of the reinsurance treaty. In case of material reinsurance, the additional credit risk amongst others resulting from valuation differences can be limited by introducing a clause in the reinsurance treaty which settles the reinsurance recoverable if the position exceeds a predefined threshold. This would be a more forward- looking way of addressing possible credit risks and would ensure that the open position with respect to the reinsurance counterparty never exceeds a certain size.*

The underlying basis of reinsurance is that the reinsurer has a different view of the underlying risk for various reasons, such as geographical or Lines of Business (LoB) diversification. The fact that a difference in valuation exists cannot be by itself a reason to settle recoverables, and certainly not before claims have been made, as

such an action would create a misalignment of incentives between cedent and reinsurer. In addition, if such a rule was put into place in other international jurisdictions, it would potentially give cause to a wealth of unjustified settlement requests due to inevitable valuation differences that would not be in the interest of the EU.

More generally, Solvency II provides a robust framework for ensuring that ceding companies' reinsurance management is appropriate having regard to their overall risk management framework. Article 44 of the Solvency II Directive requires that the risk management system covers reinsurance and Article 260 of the delegated acts requires the insurer's policies to ensure selection of suitable reinsurance and the assessment of the most appropriate arrangements.

Given the robust and coherent Solvency II framework in place and the principles underlying this framework, it is not appropriate to prescribe or recommend specific points on how reinsurance contracts should be drafted. The reinsurance treaty contract represents the outcome of a commercial negotiation between the ceding company and the reinsurer. The ceding company and the reinsurer will negotiate the treaty in the round having regard to their reinsurance risk management policies and framework and Solvency II regulation.

Assessment of the Investment strategy

6.16 *Run-off undertakings typically focus on increasing their investment returns. They can try to achieve this goal by investing in high yielding assets and/or non-listed assets. In this regard, two main investment strategies can be identified:*

- *shift to a higher risk / return asset mix;*
- *transfer the current assets of the undertaking to another undertaking (e.g. a special purpose vehicle) that can make higher profits by investing in riskier assets.*

The sentence "run-off undertakings typically focus on increasing their investment returns." is too one-sided and therefore not accurate. Run-off undertakings typically aim to manage their insurance portfolio as efficiently as possible. This is achieved in particular by means of a modern and efficient IT infrastructure to which the acquired portfolios are migrated. In terms of investment, run-off undertakings benefit from the fact that economies of scale can be generated through larger portfolios. Due to the better plannability of expenses and the lack of expenses for distribution, advantages are also possible for ALM. In addition, customers continue to participate in the surpluses that accrue, if contractually agreed. The sentence therefore could give a misleading impression, so the industry suggests deleting it.

In addition, the definition of a strategy with more risk may not be in line with reality; a portfolio with a greater diversification of low-correlated assets may lead to lower risk and higher profitability scenarios than many of the current highly concentrated portfolios in the industry. The same is true for investments in private debt that may include protections and guarantees arrangements that have lower expected default losses than public instruments.

The prudent person principle should be applied to all portfolios regardless of the institution's business strategy. Additionally, the Solvency II capital requirement adequately reflects the risks of the individual assets and a riskier investment strategy will carry a higher capital charge to protect policyholders from the undertaking increased risk profile.

6.17 *In the first strategy (i.e. shift to a higher risk / return asset mix), acquirers allocate more funds to more profitable and riskier assets, namely (private) equity and private or non-rated credit, which may no longer comply with the prudent person principle. Additionally, it might not always be possible*

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to assess the risks properly because of the complexity of the investment strategy or the complexity of the inter company structure used. The supervisory authority should monitor the changes in the investments and assess if:

- *the prudent person principle is still complied with. In case of specialised run-off undertakings, the new acquirers may have more skills to manage a more complex investment portfolio and they are expected to be able to "properly identify, measure, monitor, manage, control and report"[1] investment risks. At the same time, assets should be kept invested in the best interest of policyholders and the higher investment returns should be also passed to policyholders (via the discretionary participation features in case of with- profits contracts) while keeping an adequate level of liquidity to meet insurance obligations. For unit-linked products, considering that risks are entirely borne by policyholders, it is important that the risk/reward profile of assets is aligned with the risk-profile of the policyholders. As it may constitute a significant adaptation of unit-linked products, assets' change should be subject to the entire product oversight and governance process;*
- *the stress in the standard formula is appropriate to the new investment strategy and the criteria for the categorisation in the market or counterparty default risk module are met.*

[1] Article 132 of Solvency II Directive.

In the case of a run-off, the investment strategy does not necessarily become more complex. Without new business, for example, cash flows can be better planned, as no distribution and acquisition costs are incurred. Furthermore, synergy effects can be achieved if several portfolios are merged. In cases where portfolios of different companies continue to be managed separately, the complexity of the investment strategy should not change at all. The sentence: "Furthermore, due to the complexity of the investment strategy or the complexity of the inter-company structure used, it may not always be possible to adequately assess the risks" therefore seems misleading.

References to "higher investment return should also be passed to policyholders (via the discretionary participation features in case of with – profits contracts)" should also be clearly framed under the obligation to respect policy contract.

Assessment of the Reinsurance strategy

6.22 *For both life and non-life insurance portfolios, the use of reinsurance treaties are observed which may lead to a material impact on the own funds (due to the reinsurance recoverables) and the SCR partially compensated by an increase in the SCR counterparty default risk.*

It should not be generally assumed that the impact of reinsurance treaties is only partially compensated by an increase in the SCR counterparty default risk, as this paragraph seems to imply. Rather, this should be the general case and any suggestion otherwise would imply a miscalibration of the standard formula counterparty default risk.

In addition, it is of utmost importance to acknowledge that reinsurance does not novate automatically to the transferee along with the transfer of the underlying business, as in most jurisdictions this underlying business is transferred gross (without its reinsurance).

6.23 *Supervisory authorities should discuss with the undertakings with high cession rates in particular to assess the following:*

- *reinsurance concentration: in case of material reinsurance with a high cession rate with respect to a single or few reinsurers, a concentration risk can arise with respect to the reinsurance counterparty. This concentration risk might not be fully reflected in the SCR e.g. for the case of a downgrade of the*

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> *single reinsurer or when financial or underwriting stresses increase the probability of default of the single reinsurer;*
>
> - *collateral: the counterparty risk could be reduced if collateral would be posted. Risk-based haircuts can be used to incentivise the reinsurer to use high-quality, liquid and short-term assets as collateral. Lastly, the adjustment of the collateral or the margining should be considered to ensure that this occurs within a sufficiently short delay when needed;*
> - *retrocession: in case of high retrocession the reinsurer is merely fronting and not taking on any risk and the final risk-taker is the retrocessionaire. Specific attention is needed in case the retrocessionaire is not based in the EU. Other legislation with regard to the valuation of the technical provisions or the required solvency margin might be applicable. The ceding insurance undertaking as well as NCAs should ask for information on retrocession in cases where this seems relevant.*

Insurance Europe assumes that EIOPA is referring to the company taking up the run-off book. The novation of reinsurance in a portfolio transfer is not automatic. Partly for this reason, the issues described above are not typical in runoff situations.

With regards to collateral, this point implies EIOPA's support for collateral arrangements in reinsurance treaties. This point should be removed, as any such implication for treaties with reinsurers subject to Solvency II (or any equivalent framework) must be avoided, having regard to the principles underlying Solvency II and the regulation of EU reinsurers under that Directive. In particular Article 134 of the Solvency II directive prohibits regulatory requirements for the pledging of assets where the reinsurer is EU authorised (similarly for article 173 for equivalent reinsurers). The paragraph also goes further in describing how collateral arrangements should be structured.

Furthermore, EIOPA's suggestion seems to imply that demanding collateral is a costless method for reducing risk. It is not. Were collateral demands to become more widespread, this would inevitably increase the cost of (re)insurance. In an economic framework it should be left to the two parties of a transaction to agree on how much risk appetite they have and what price they are willing to pay. Encouraging collateral across the board would not be aligned with such a principle.

With regards to retrocession arrangements, again it is not reasonable to expect a cedent to scrutinise the retrocession arrangements of its reinsurer, as this would not be proportionate to the resources of the insurance undertaking. This is particularly the case, since it is reasonable to expect that, if a reinsurers' retrocession arrangement is for whatever reason unsuitable, this would be reflected in that reinsurers' credit rating.

Furthermore the information which the reinsurer can provide to the ceding company on its retrocession arrangements is likely to be limited to publicly available information. Solvency II already provides for extensive disclosure for EU reinsurers and this is sufficient. If the local NCA has any concerns about the EU reinsurer, it should first consult that reinsurer's NCA.

It should also be noted that, even upon entering a retrocession contract, a reinsurer remains liable to pay any claims deriving from the reinsurance contract with the cedent with the entirety of its assets. Therefore, a cedent's claims will be paid by the reinsurer even if the reinsurer does not receive retrocession recoverables from the corresponding retrocession contract. In addition, it is discriminatory to point the finger at non-EU reinsurers where an equivalence assessment is an integral part of Solvency II and at the very least reinsurers based in these jurisdictions can be expected to be under a level playing field with EEA reinsurers.

Furthermore, in the exceptional cases where a failure of the reinsurer is imminent which is not reflected in credit ratings, it should be noted that there are sufficient protection to deal with this situation.

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6.24 *As indicated in EIOPA's Opinion on the use of risk mitigation techniques, insurance and reinsurance undertakings - when calculating the Basic SCR - should take into account risk-mitigation techniques as referred to in Article 101(5) of Solvency II and complying with Articles 208-214 of the Delegated Regulation. Where the reduction in the SCR is not commensurate with the extent of the risk transferred or there is not an appropriate treatment within the SCR of any material new risks that are acquired in the process, insurance and reinsurance undertakings should consider that the risk-mitigating technique does not provide an effective transfer of risk.*

While this is true and welcome the principle-based assessment underpinning this paragraph, the industry notes that those situations where the reduction of SCR is not commensurate with risk transfer ought not to be the rule and should be subject to a materiality assessment in line with the comments in the Opinion referred to. It is not clear to us what material new risks would be acquired with a reinsurance cession (except for counterparty default risk, which is dealt with elsewhere), and how these might be so material to question the effective transfer of risk. In contrast, creating barriers to the recognition of risk-mitigation techniques could discourage insurance undertakings from transferring risks to reinsurers and thus reduce risk diversification.

The second sentence in the above paragraph should be deleted as it does not provide the full context, but rather a selected excerpt of the EIOPA opinion and the regulation.

6.25 *Run-off undertakings with material exposures e.g. due to reinsurance treaties with a high cession rate, have material counterparty default and concentration risks as well as possible basis risks due to imperfect margining of the collateral. Due to this idiosyncratic risk profile, it is important to evaluate, in the context of the ORSA, the appropriateness of the standard formula. The supervisory authorities should closely monitor and challenge the appropriateness of the standard formula. If insufficient evidence shows that the standard formula underestimate the SCR, supervisory authorities should ultimately consider using their power under Article 37 of Solvency II and require a capital add-on. Where the SCR is calculated with an internal model, this assessment is also part of the model application or model change process.*

Simply reinsuring a large proportion of risk by itself does not result in an underestimation of the counterparty default (and, where applicable, concentration) risks. If it did then the formula for the counterparty SCR is called into question. Insurance Europe further notes that remoteness in the attachment point does not by itself basis risk. Only in exceptional cases where the counterparty SCR for whatever structural reason does not adequately reflect the risk should further steps be envisaged.

6.26 *The decision to go into a partial/full run-off in many instances represents a material change in the risk profile and should trigger an ad-hoc ORSA, in accordance with Article 45(5) of Solvency II.*

The industry agrees, but an ad-hoc ORSA should only be requested if the risk profile of the undertaking changes significantly by the decision to go into a run-off (which might not be the case in a partial/full run-off).

6.27 *If the material reinsurance counterparty default and concentration risk is not fully captured by the SCR as demonstrated within the ORSA, and to make sure that the solvency position of the cedent remains guaranteed, the supervisory authority can request the undertaking to:*

- *limit the cession rate to an upper bound. A minimum retention of risks by the undertaking ca be required by the supervisory authority;*
- *incorporate collateral or a reinsurance deposit consisting of high quality investments with a swift margining mechanism;*
- *incorporate financial guarantees to ensure that capital will be injected if the solvency ratio drops below a specific threshold.*

The industry agrees that, in a situation where the capital relief in a reinsurance cession is not commensurate with the risk transferred, the ORSA would be the appropriate place to assess such a risk. However, even in such a situation, the industry struggles to see how setting an upper bound on the cession rate would reduce rather than increase the risk. Insurance Europe is also not sure how an ex-post demand for collateral would work in practice, as there is a risk that the reinsurer may — reasonably — not want to provide the collateral or provide it only at a higher price. See comments on collateral under 6.23 comments above.

It is further not clear whether the guarantees discussed would come from the reinsurer: if this is the case, this would be an unusual situation indeed and only envisageable in intra-group transactions, as otherwise it seems unlikely that an alignment of interest could be reached. This point is not specific to the reinsurance section and should be placed elsewhere in the paper if maintained (presumably the parent would inject capital under a range of circumstances, not just related to reinsurance specifics).

Moreover, no additional capital requirements for undertakings meeting their SCR ratio should be introduced, so any request by supervisory authorities to incorporate financial guarantees should be limited to undertakings in breach of the SCR. The points in this paragraph again do not recognise the existing risk management requirements under Solvency II. The wording is very strange and does not recognise the principles of Solvency II (eg the supervisor needs to make sure the solvency position of the cedent remains "guaranteed") or the ladder of supervisory intervention under Solvency II. Regarding the sub-bullets, the first point implies that a supervisor can have the power to intervene directly in an existing reinsurance contract in the circumstance described, thereby over-ruling the law on which that contract is based. It is questionable whether supervisors would have a legal basis to use such a power even if they were prepared to do so (see comments under 6.15 regarding supervisory inference in new reinsurance contracts).

This paragraph needs to be either completely deleted or amended to be consistent with and include appropriate references to Solvency II regulations. The risk based haircuts in 6.23 is the right approach.

6.28 *Supervisory authorities should closely monitor the reinsurance policy and assess if the policy is adequate to the portfolio of technical provisions of the run-off portfolio.*

The focus should not be the assessment of if the policy is adequate to the portfolio of technical provisions of the run off portfolio, but that the capital base is satisfactory.

CONDUCT OF BUSINESS SUPERVISION

7.1 *From a conduct of business supervision perspective, specific risks can arise in the case of run-off activities and it is necessary to ensure that the interests of the policyholders remain protected.*

EIOPA should clearly define what specific risks could arise. All matters covered in points 7.2 to 7.7 are applicable to every undertaking operating in the market in any type of business.

7.4 *Specifically in case of life business and medium and long-term commitments in run-off, supervisory authorities should assess whether the accepting insurance undertaking has a customer centric business model, including the plant to ensure that customers belonging to the run-off portfolio will be treated fairly throughout the lifecycle of the run-off products. In particular:*

- *they should assess the product oversight and governance policy of the accepting undertaking to ensure that it is adequately implemented and that it is adequate and proportional vis-à-vis the level*

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> *of complexity of the products concerned in the portfolio transfer and the target market's characteristics.*
> - *they should pay particular attention to how acquiring/accepting undertakings are expected to consistently monitor and regularly review the products within the acquired portfolio and when instances of consumer detriment arise how they plant to take adequate remedial actions.*

The clear focus of run-off undertakings on existing policyholders could also be beneficial.

> **7.7** *The level of customer service should not be significantly different to the level of customer service of the transferring undertaking as to cause possible consumer detriment. This is to be assessed taking into account parameters such as the agility of the communication channels with the client, customer language, response times and other metrics that can influence the perception and effective customer service. While procedures and process can vary, it should not be materially more difficult for customers to carry out any activity related to policy servicing, e.g. submitting a claim, assessing information, submitting a complaint. The supervisory authority may require additional reporting on the service level.*

No additional information on the level of service should be required when the supervisor already has the information it regularly receives from institutions.

IMPACT ASSESSMENT

> **1.** *Do you share EIOPA's view that run-off business model is particularly challenging (e.g. due to its specific risk profile, the difficulties of the process and assessment of the change of ownership, the lack of specific provisions on run-off in the Solvency II framework, etc) and that the release of a Supervisory statement by EIOPA will contribute to ensure a high quality and convergent supervision of run-off undertakings/portfolios?*

The industry welcomes EIOPA's supervisory statement and its engagement on this matter, but cautions against overly prescriptive requirements for certain segments of the insurance industry.

Most of the issues raised in the Supervisory Statement reflect supervisory challenges and principles that apply to any undertaking irrespective of whether the company is in run-off or underwrites new business and its shareholder structure. The risk-based approach of Solvency II, regulations on policyholder protection and the existing supervisory powers provide the adequate framework to deal with the vast majority of these issues. By issung this Supervisory Statement referring exclusively to run-off business may give the impression that the same principles do not apply to the rest of the market.

Additionally, the run-off concept is not self evident and so the potential application of this paper to transactions unclearly defined. This applies to questions 3 to 8 below.

> **2.** *Do you agree with the dialogue with NCA, proposed in section 4, with regard to the decision to go into run-off? (If not, please explain the reasons why)*

While Insurance Europe agrees that it is in the best interest of undertakings to inform supervisory authorities once they settle on the decision to suspend their underwriting activities, and discuss the aspects mentioned above, it is worth to clarify that no legal notification requirement applies.

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3. *Do you agree with section 5 of the Statement referred to the acquisition of run-off undertakings or transfer of run-off portfolio, that EIOPA proposed in light of the growing interest in such acquisitions, also by private equity or similar investment entities?*

Supervisory authorities should understand the run off business model regardless of a specific case presented to them. The prudent supervision of any insurance business transfer should be based on this understanding. It is understood that the aim is that the involved parties to the transfer will:

- Continue to have appropriate financial resources,
- Have appropriate resources to manage and monitor risk,
- Be fit and proper to conduct their business prudently; and
- Be capable of being effectively supervised. At the same time, any supervision should not significantly delay any run off transactions.

It should be made clear that compared to other ownership structures, private equity could also bring benefits to insurance undertakings, such as focus on lower costs, leaner and more efficient management structures, experience from other run-off undertakings etc.

4. *Do you agree with section 6 of the Statement with regard to the on-going supervision of the Business Model (points 6.2 to 6.5)?*

It should be added that a more efficient handling of claims does not necessarily have negative effects. It could also reduce handling costs and therefore eventually increase discretionary benefits.

5. *Do you agree with section 6 of the Statement with regard to the on-going supervision of Technical Provisions (points 6.6 to 6.15)?*

It should be mentioned that higher lapse rates have not been observed in case of run off yet.

For reinsurance recoverables, an underlying basis of reinsurance is that the reinsurer and cedent have different views and treatment of the underlying risk for various reasons including different risk profiles and this is reflected in the technical provisions. See detailed answers separately to specific points.

6. *Do you agree with section 6 of the Statement with regard to the on-going supervision of Investments (points 6.15 to 6.21)?*

In the case of a run-off, the investment strategy does not necessarily become more complex.

7. *Do you agree with section 6 of the Statement with regard to the on-going supervision of the Reinsurance strategy (points 6.22 to 6.28)?*

Some of the proposals on the supervision of reinsurance strategy are not consistent with the Solvency II framework. It is sufficient here for EIOPA to remind supervisors to be aware of the existing requirements in Solvency II relevant for the reinsurance strategy and apply these as appropriate to the run-off business model. See answers separately to specific points.

8. *Do you agree with section 6 of the Statement on Conduct of business supervision?*

Insurance Europe agrees with the overall observations. There are also positive effects, as the focus of run-off undertakings is on the existing customer.

9. *Is there any supervisory assessment/analysis that it is missing in the Statement that you find relevant to introduce? (If yes, please add a bit of background)*

A clear statement that, in any transfer, the parties must be aware that in most EU countries the insurance business transfers without reinsurance., and that therefore it is of utmost importance that the company acquiring the portfolio:

- Is financially sound enough to take the portfolio without any reinsurance on the balance sheet or,
- That it has adequate (new) reinsurance protection in place or,
- A novation agreement with the former reinsurer (of the company transferring the business) in place that the reinsurance is being transferred with the insurance business acquired.

Additionally, the industry would welcome a more consistent distinction of the particularities of life vs non-life business, portfolio transfers vs M&A, and where the participants are run-off companies or companies writing new business that also participate in the runoff market and/or have certain portfolios in run-off.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total

European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers pay out almost €1 000bn annually — or €2.7bn a day — in claims, directly employ nearly 950 000 people and invest over €10.4trn in the economy.