EIOPA-BoS-16-008
27 January 2016

Opinion of the European Insurance and Occupational Pensions Authority (EIOPA) on the application of a combination of methods to the group solvency calculation

Legal background

1. This opinion is issued under Article 29(1)(a) of Regulation (EU) No 1094/2010 of the European Parliament and of the Council (hereafter the 'Regulation')[1]. As established in Article 29(1) of the Regulation, EIOPA shall play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union.

2. Pursuant to Article 230(1) of Directive 2009/138/EC of the European Parliament and of the Council[2], when method 1 (consolidation) is used exclusively, the consolidated Solvency Capital Requirement (SCR) should serve as a basis to calculate the tier limits, which are used to determine the own funds eligible to cover the consolidated group SCR.

3. Pursuant to Article 233(1) of Directive 2009/138/EC, when method 2 (deduction and aggregation) is used exclusively, the SCR of each undertaking should serve as a basis to calculate the tier limits that are used to determine the own funds eligible to cover the SCR of those individual undertakings.

4. When taking a decision to allow the group solvency to be calculated in accordance with method 2 or a combination of methods 1 and 2, the group

[1] 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)

[2] 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)

supervisor needs to consider the criteria specified in Article 328(1) of the Commission Delegated Regulation (EU) 2015/35[3], in particular:

- if there are significant intra-group transactions between the part of the group covered by method 1 and the part of the group covered by method 2;
- if the use of method 2 in relation to a particular undertaking(s) would materially affect the results of the group solvency calculation;
- whether the solvency regimes of the relevant third countries are equivalent or provisionally equivalent.

5. In addition, according to Recital 125 of Commission Delegated Regulation (EU) 2015/35, where a group includes related third-country insurance or reinsurance undertakings, and where the solvency regimes of those third countries have been determined as equivalent or provisionally equivalent, the group supervisor should give such a consideration priority when deciding on whether method 2 should be used exclusively or in combination with method 1.

Context and scope

6. In EIOPA's opinion, when a combination of methods is used for the calculation of the group solvency, the provisions of Directive 2009/138/EC relevant for each method should be applied respectively. This means that distinct tier limits should be used, on the one hand, for the part of the group covered by method 1 (where tier limits are based on the SCR of the consolidated part of the group, i.e. the consolidated group SCR) and on the other hand, for each undertaking covered by method 2 (where tier limits are based on the individual SCRs of the undertakings). In addition, in EIOPA's opinion it is not adequate: i) to use the total group SCR to calculate tier limits in relation to the consolidated part, or ii) to calculate the group own funds as if method 1 was used for the entire group.

7. At the same time EIOPA recognises that the use of a combination of methods may lead to unintended consequences if it is used by groups which, for example, organise their funding through a central holding company, i.e. when the debt borrowed at the holding company level is used to finance undertakings covered by both method 1 and method 2. In such a situation, as a consequence of the strict application of method 1 rules to undertakings

[3] Commission 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, 17.01.2015, p. 1).

covered by this method (including the one formally issuing the debt), the tier limits used to assess the eligibility of the subordinated debt would be determined only on the basis of the consolidated part of the group SCR.

8. The combination of methods can be applied if it is allowed by the group supervisor on the basis of a discretionary decision, which should be taken after careful consideration of all relevant information available. In EIOPA's opinion even if priority should be given to the equivalence criterion, all criteria should be taken into consideration. Against this background, the group supervisor should assess the potential impact of the application of a combination of methods before taking the decision. If the assessment shows that the outcome of the group solvency calculation using a combination of methods would not reflect the real financial position of the group, because of the funding of undertakings covered by both methods through a holding company by means of a subordinated debt, then the impact of applying a combination of methods should be carefully assessed by the group supervisor.

9. If the application of a combination of methods is allowed in such a situation, then the group supervisor may need to allow specific solutions to avoid unjustified disadvantages. The solution applied could imply that, in relation to intragroup funding transactions, the own funds of the group are assessed as if the group has chosen a different funding solution.

10. To ensure that the prudential concerns are duly addressed and that the specific solutions do not place groups concerned in an advantageous position as compared to groups using exclusively method 1, EIOPA recommends that the following conditions should be satisfied:

    (i) a separate basis for calculation of the tier limits is maintained (as described in paragraph 6);

    (ii) the amount of eligible subordinated debt at the level of the group should not exceed the one that would have been calculated if the group had applied exclusively method 1;

    (iii) if a prudential regime of an equivalent or provisionally equivalent third country does not categorise own funds into tiers or defines tiers which are significantly different from those established under Directive 2009/138/EC, then the own funds brought in by method 2 should be allocated to tiers according to the principles laid down in Articles 87 to 99 of Directive 2009/138/EC for each individual third-country undertaking.

11. EIOPA considers that in order to foster a common supervisory culture, the intention to apply the specific solution referred to in paragraph 9 should be properly discussed with and approved by the group supervisor. The impact of the solution proposed should also be presented to the group supervisor. The solution referred to in paragraph 9 should be subject to the implementation of an efficient internal monitoring of the capital in- and out-flows of the third-country undertakings by the group. EIOPA considers that to ensure efficient and consistent supervisory practices, the group needs to be required to report such information to the group supervisor so that the group supervisor is able to see that there is no double use of eligible own funds. This means that the solution applied should be based on the effective net capital inflow in the third country.
12. In order to assist in consistent supervisory approaches, EIOPA considers that the reasons for the application of the specific solution and the explanations justifying why the solution chosen reflects the solvency position of the group in a more appropriate way should be properly disclosed as part of the group Solvency and Financial Condition Report.
13. EIOPA will monitor the developments of the issues addressed in this opinion and, if appropriate, will review the opinion accordingly.
14. This opinion will be published on EIOPA's website.

Done in Frankfurt am Main, 27 January 2016

[signed]
Gabriel Bernardino
EIOPA Chairperson
For the Board of Supervisors