



## “Solvency II 2020 Review Risks and opportunities for run-off business”

Benelux Run-Off FORUM '19 – 21 november 2019

Sandra Lodewijckx, Partner  
Alexander Hamels, Associate

**LEGAL INSIGHT. BUSINESS INSTINCT.**

# About Lydian

- Belgian independent full-service business law firm
- Founded in 2001
- Offices in Brussels, Antwerp and Hasselt
- 85 lawyers (16 insurance lawyers)

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*“Lydian's ‘internationally-focused’ team ‘knows the market’ and is ‘unique in Belgium in its knowledge about jurisprudence, case law and compliance in the insurance business’ – “top-class international insurance lawyers” – Legal 500*

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# Solvency II 2020 Review – Risks and opportunities for run-off business

## 1. Introduction

- Definition of “run-off business”
- Market exit strategies in Belgium – brief overview
- Solvency II – accelerator for run-off transactions

## 2. EIOPA Consultation Paper on Solvency II 2020 Review

- Background
- Discussion of selected topics
- Key takeaways & next steps

## 3. Q&A

# 1.1. Defining “run-off”

- no legal definition
- few literature
- run-off *sensu strictu*

“(Re)insurance undertakings that no longer have an insurance license but are in the process of liquidating an insurance portfolio or technical liability.”

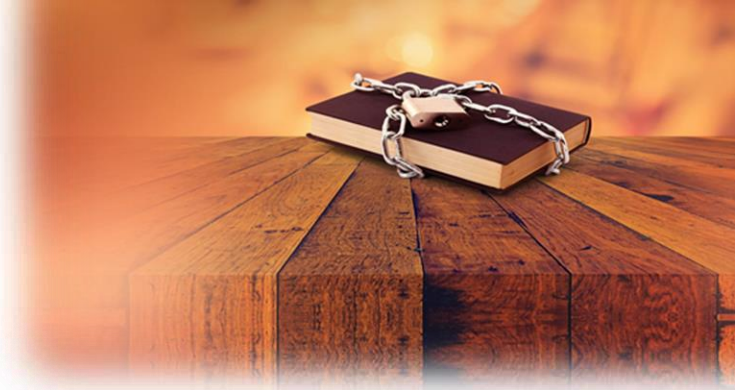
Source: National Bank of Belgium (Circular CBFA\_2010\_31-2).

- run-off *sensu lato* (= run-off / legacy / inactive business / discontinued business / closed book)

“A part of business underwritten in the past, for which there are still existing obligations (actual and potential insurance liabilities), but no new business is underwritten and in most cases it no longer generates premium income.”

Source: O. KHOMENKO, “Solvency II and its impact on discontinued business in non-life insurance”, *European Insurance Law Review*, vol. 2016, no. 2, 2016.

-> All (re)insurance undertakings are somehow involved in run-off



# 1.1. Reasons for run-off



## FINANCE

- unprofitable portfolio
- capital deployment
- insolvency / liquidation
- conversion of volatile portfolio to fixed value (portfolio transfer)
- ratings & access to financial securities (portfolio transfer)

## STRATEGY

- focus on core business
- change of business objectives & strategy
- group strategy
- change of control
- m&a activity (e.g. m&a dealbreaker, post-merger integration, by-product of a transaction)
- spillover effect of reputational damage

## REGULATION

- Solvency II (capital requirements)
- loss or suspension of license
- regulatory differences between jurisdictions
- legal uncertainty
- aml risk
- international economic sanctions
- litigation
- supervisory action

# 1.1. Understanding “run-off business”



	Passive run-off	Active run-off
<b>profitability</b>	low	high
<b>hr</b>	Classic (internal?)	specialised & tailored to size (third party?)
<b>capital management</b>	static	dynamic release of capital
<b>reserves management</b>	holding to expiration	accelerated reduction
<b>claims management</b>	passive	active
<b>management focus</b>	other lines of business	run-off business
<b>finality</b>	classic lifespan of insurance contracts	accelerated run-off and early finality (portfolio transfer, commutations, novations, etc.)

**Figure 1:** Estimated global non-life run-off liabilities

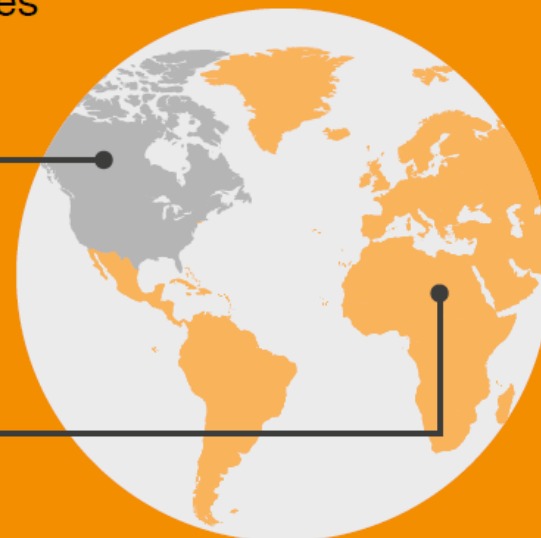
**Market size**

The North American run-off market represents nearly half the size of the global legacy market.

North America  
US\$**364bn**

Rest of the World  
US\$**427bn**

Source: PwC



Source: PwC Global Insurance Run-off Survey 2019



## 1.2. Market exit strategies





# 1.3. Solvency II – Accelerator for run-off business



## Solvency II

### A. Quantitative requirements

- capital requirements (SCR, MCR)
- Solvency II balance sheet

-> capital charge of a run-off portfolio could be 10x higher than before SII (Endres, De Galhau, 2010)

### B. Qualitative requirements

- ORSA & Supervisory Review Process (SRP)
- system of governance

#### challenges:

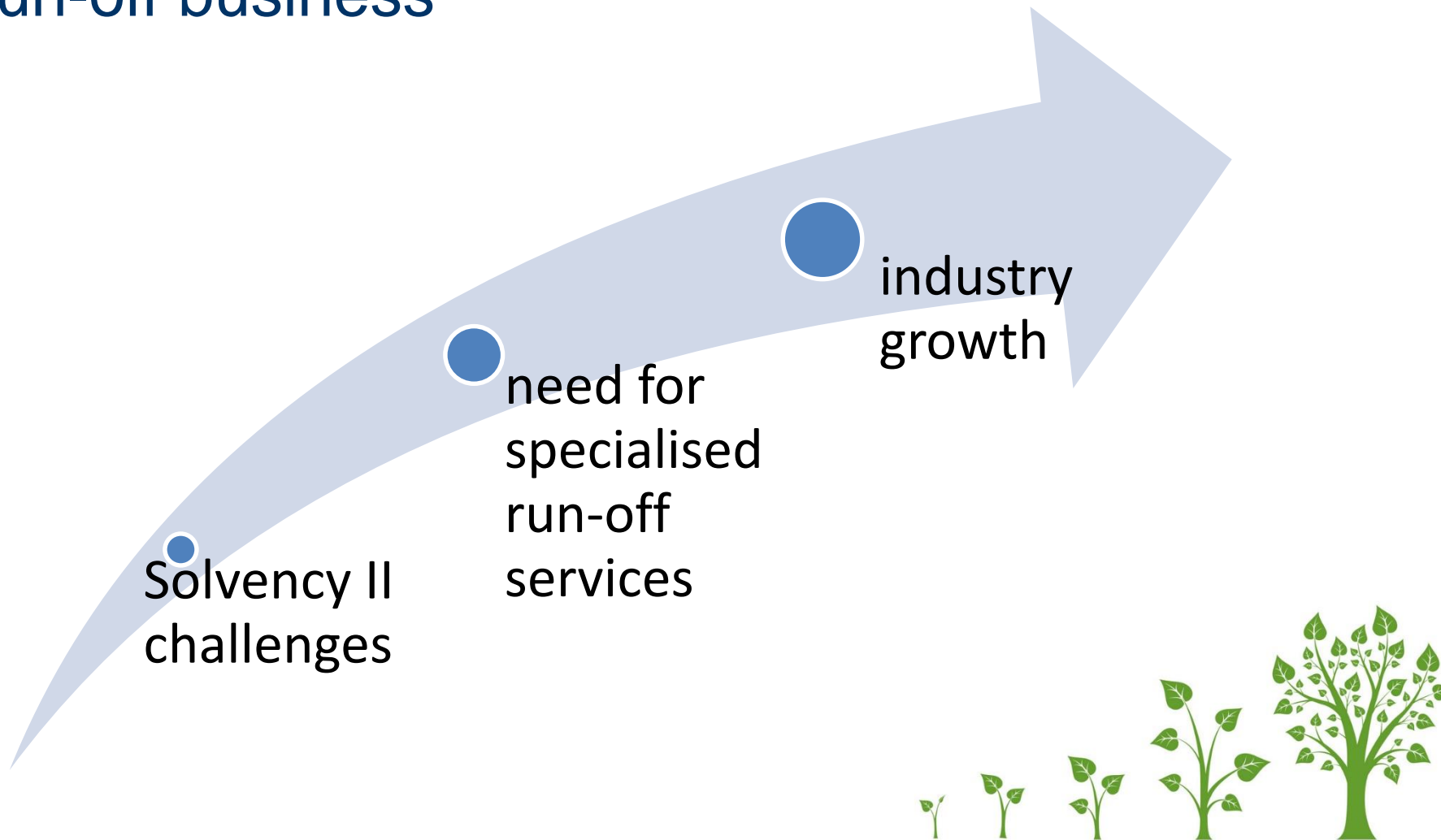
- limited staff
- old records (AML?)
- Estimation of assets and liabilities for ORSA
- Capital add-ons after SRP?

### C. Reporting & disclosure

- reporting to supervisor & general public

reputational risk & ratings

## 1.3. Solvency II – Accelerator for run-off business



## 2. EIOPA Consultation Paper on Solvency II 2020 Review



EIOPA-BoS-19/465  
15 October 2019

**Consultation Paper  
on the  
Opinion on the 2020 review of  
Solvency II**

## 2.1. EIOPA Consultation Paper on Solvency II 2020 Review - Background

- Solvency II Directive
  - (Article 77f, 111(3), 129 and 242 (2))
- European Commission's Request to EIOPA for technical advice on the review of the Solvency II Directive, 11 February 2019
- Three EIOPA Consultations:
  - Consultation on Solvency II 2020 Review + Impact Assessment
  - Consultation on Advice on the harmonisation of national insurance guarantee schemes (*closed*)
  - Consultation on supervisory reporting and public disclosure (*closed*)

## 2.1. EIOPA Consultation Paper on Solvency II 2020 Review - Background

Solvency II Directive:  
4 areas of review

long-term guarantees measures and measures on equity risk

Solvency Capital Requirement standard formula

Member States' rules and supervisory authorities' practices regarding the calculation of the Minimum Capital Requirement

group supervision and capital management within a group of insurance or reinsurance undertakings

EC Request to EIOPA for technical advice:  
addition of 15 additional areas of review

transitional measures

risk margin

Capital Markets Union aspects

Dynamic modelling of the Volatility adjustment

Techniques used to reduce Solvency Capital Requirements

macroprudential issues

recovery and resolution

insurance guarantee schemes

freedom to provide services and freedom of establishment

Group supervision

reporting and disclosure

proportionality and thresholds

best estimate

own funds at solo level

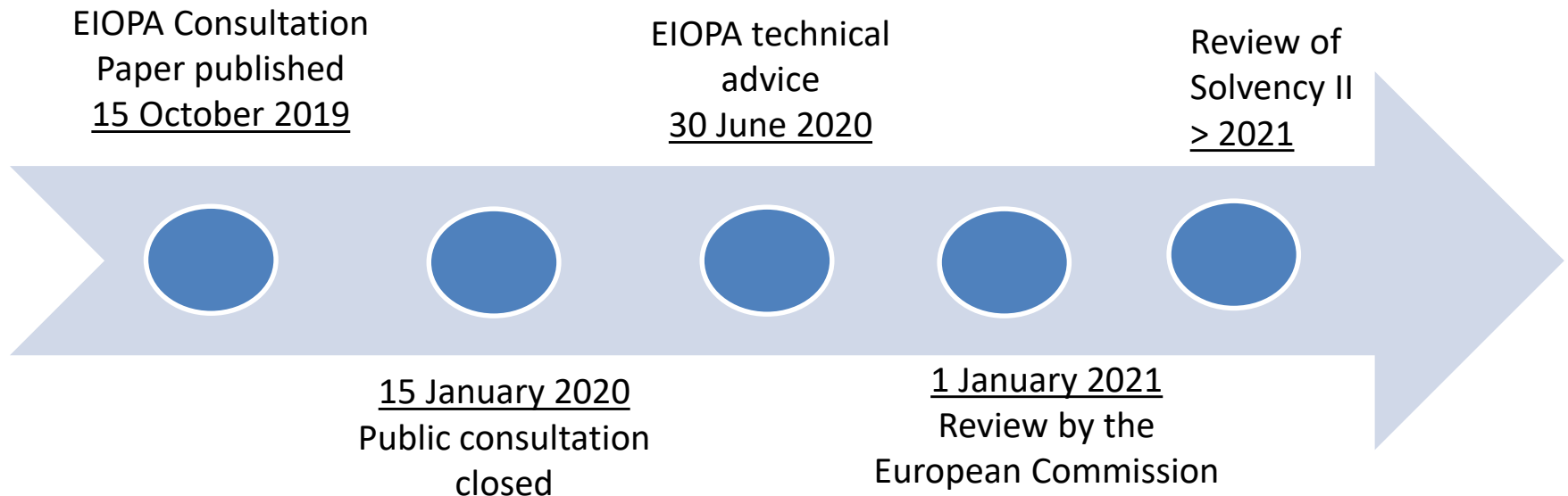
Reducing reliance on external ratings

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review



- 878 pages Consultation paper
- 260 pages impact assessment
- three blocks of proposals:
  1. long term guarantee measures
  2. new regulatory tools
    - macro-prudential issues
    - recovery and resolution
    - insurance guarantee schemes
  3. revision to the existing Solvency II framework, e.g.
    - freedom of services and establishment
    - reporting and disclosure
    - solvency capital requirements

## 2.1. EIOPA Consultation Paper on Solvency II 2020 Review - Background



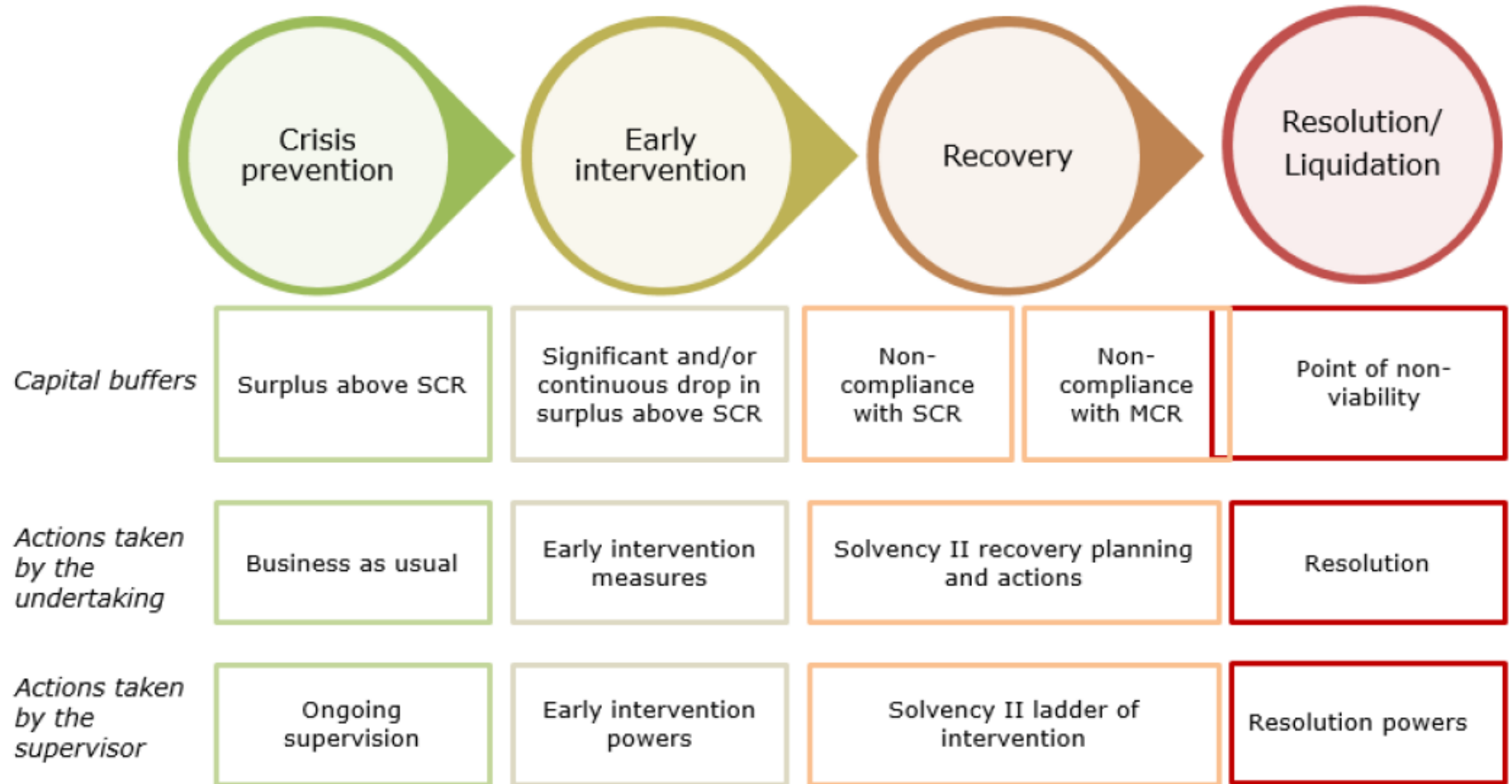


## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review



- Recovery & Resolution
  - minimum harmonisation
  - protection of financial stability
  - principle of proportionality
  - also applicable to reinsurance undertakings
  - proposals inspired on:
    - EIOPA 2017 Opinion on the harmonisation of recovery and resolution frameworks for (re-insurers across the Member States)
    - FSB Key attributes of effective resolution regimes for financial institutions
    - Bank Recovery and Resolution Directive (BRRD)
    - IAIS ICP 12 and ComFrame (November 2019 reforms?)
    - ESRB reports on recovery and resolution for the insurance sector

Figure: Crisis management flow



Source: EIOPA Consultation Paper on the Opinion on the 2020 review of Solvency II

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Crisis prevention



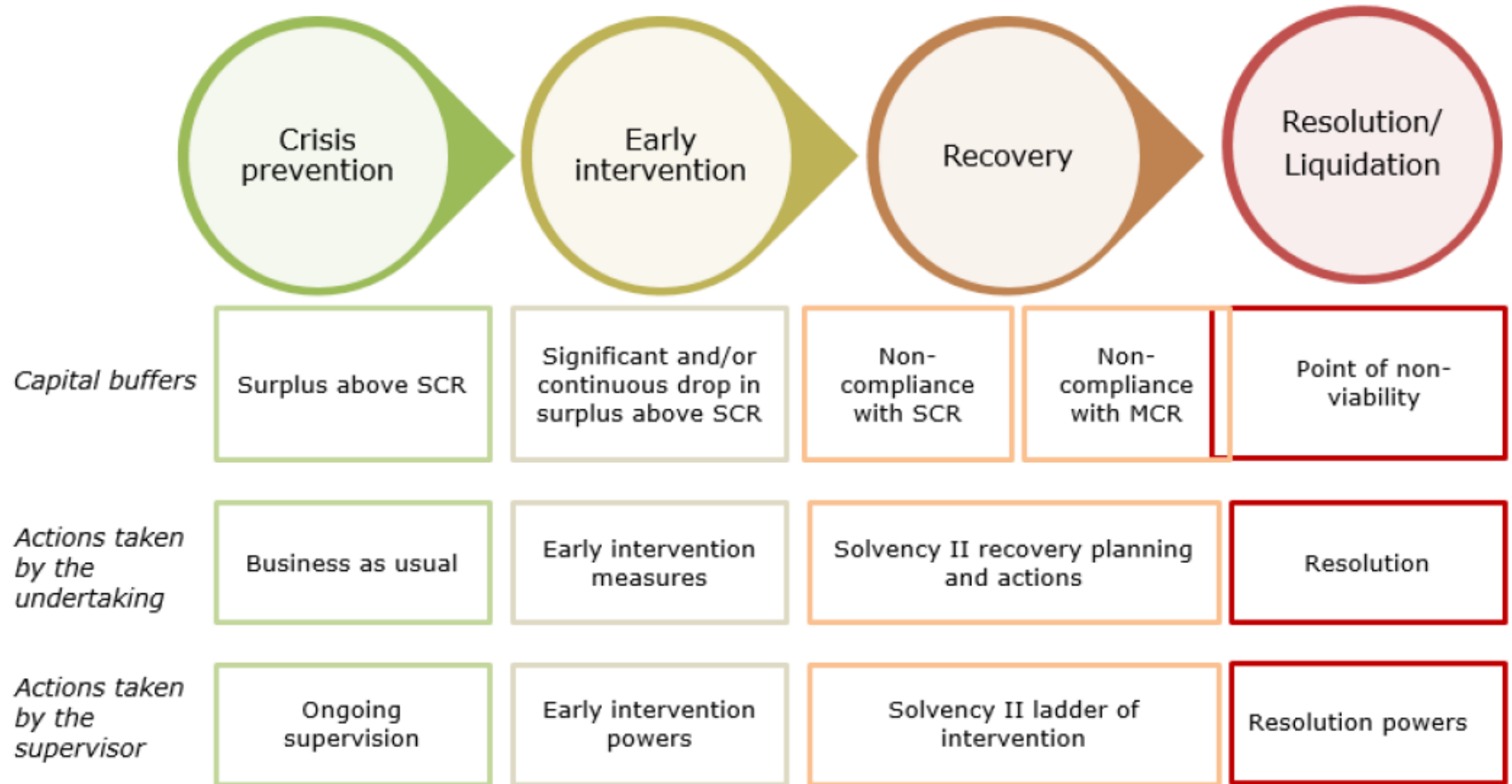
- context: normal course of business
- pre-emptive recovery planning
  - development of operations, risks and recovery options for stress scenarios
  - principle of proportionality
    - Not all (re)insurers are concerned
    - Option of simplified obligations (content and frequency)
- at group level or, if NSA requires, at solo level
- currently no harmonisation
  - different from ORSA, SII recovery plans or resolution planning

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Crisis prevention



- context: normal course of business
- pre-emptive resolution planning
  - development of resolution plans and resolvability assessments
  - principle of proportionality
    - not all (re)insurers are concerned -> scope is smaller than recovery planning
    - option of simplified obligations (content and frequency)
- at group level or, if NSA requires, at solo level
- different from recovery planning

Figure: Crisis management flow



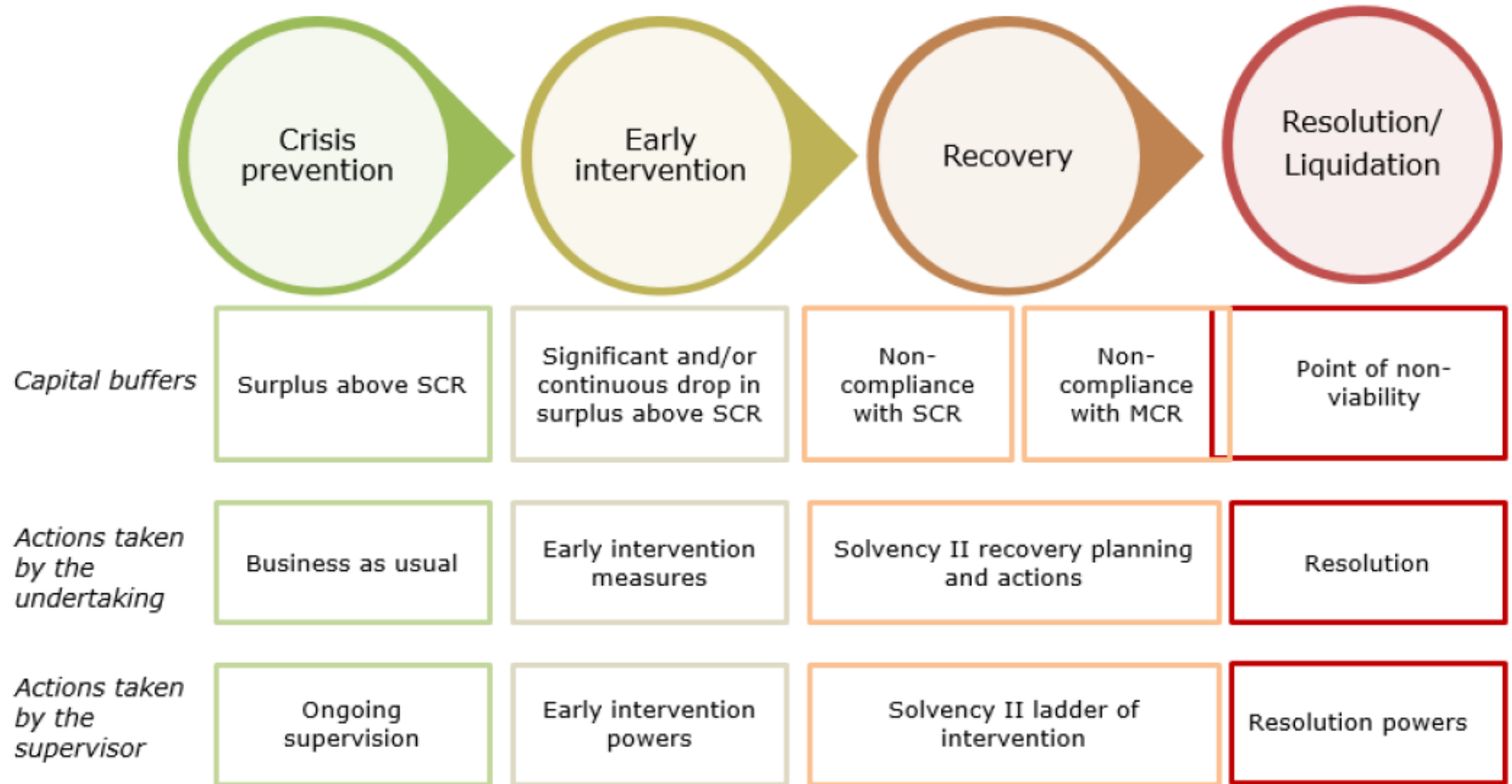
Source: EIOPA Consultation Paper on the Opinion on the 2020 review of Solvency II

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Early intervention



- context: deteriorating financial conditions (but not yet a breach of SCR and MCR)
- intensified supervision, NSA may require:
  - additional or more frequent reporting
  - update or implement measures set out in the pre-emptive recovery plan
    - e.g. raise capital, governance changes, adjustments to business lines and operations, limitation of asset transfers
  - in case no pre-emptive recovery plan is available: draft recovery plan
  - limit variable remuneration and bonuses
  - exceptionally: suspend or limit the right of policyholders to surrender their contracts (“policy freeze” or “bail-in”)
- no new capital requirements

Figure: Crisis management flow



Source: EIOPA Consultation Paper on the Opinion on the 2020 review of Solvency II

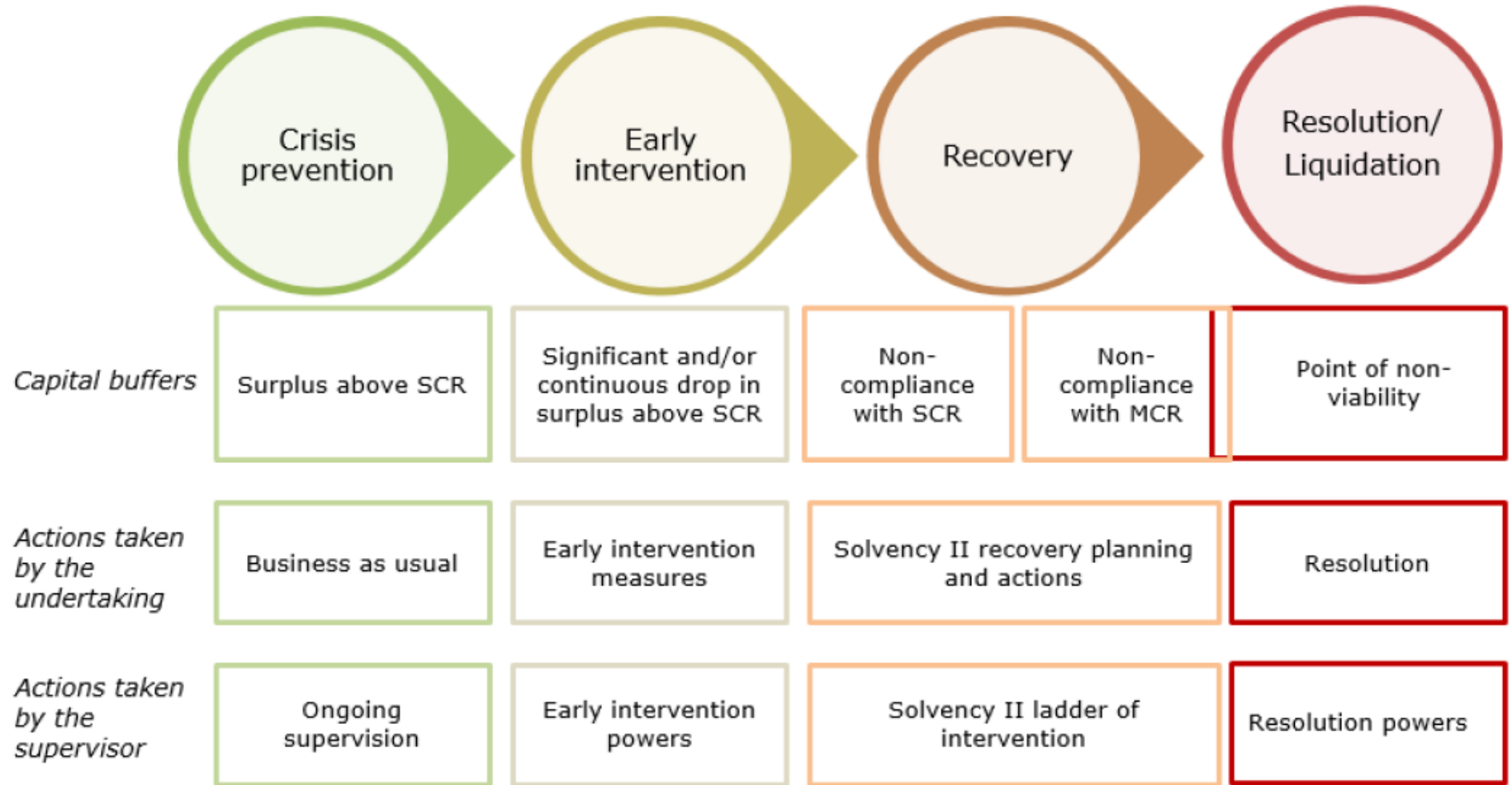


## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Recovery



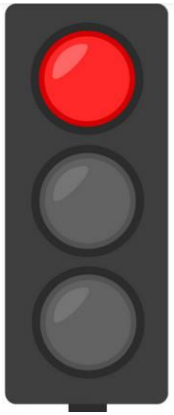
- context: breach of SCR / MCR
- no new proposals
  - breach of SCR remains trigger for entry into recovery
- articles 136-140, Solvency II
  - notification
  - recovery plan and re-establishment of SCR and/or MCR
  - regulatory intervention
    - limitation of free disposal of assets
    - withdrawal of authorisation
    - *“all measures necessary”*

Figure: Crisis management flow



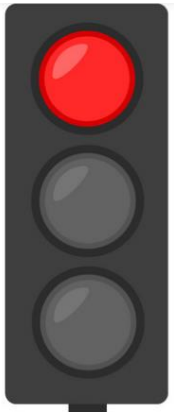
Source: EIOPA Consultation Paper on the Opinion on the 2020 review of Solvency II

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Resolution



- context:
  - point of non-viability
  - recovery measures have been exhausted or cannot be implemented in a timely manner; and/or
  - necessity for the public interests
- four principles:
  - protection of policyholders, beneficiaries and claimants
  - financial stability
  - continuity of functions whose disruption could harm financial stability and the real economy
  - protection of public funds
- designation of a (national) resolution authority

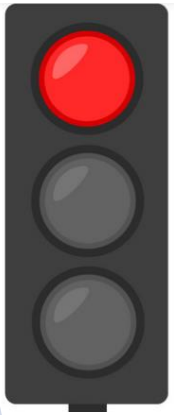
## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Resolution



### Resolution Authority's competences

- prohibit the payment and allow the recovery of variable remuneration
- withdraw the license to write new business and put all or a part of the business into run-off
- share transfer
- assets and liabilities transfer / portfolio transfer
- policy freeze
- stay rights of reinsurers to terminate or not reinstate coverage on the basis of the ceding undertaking entry into resolution

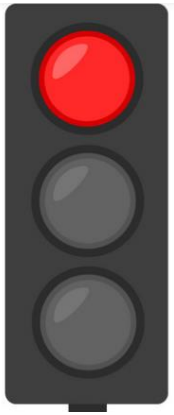
## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Resolution



### Resolution Authority's competences

- stay rights of creditors
- ensure continuity of essential services intra-group
- take control of the insurer in resolution
- derogate from the general principle of equal treatment of creditors of the same class (*pari passu*)
- restructure, limit or write down liabilities and allocate losses to shareholders, creditors and policyholders

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Resolution



- bail-in over bail-out, but:
  - allocation of losses to policyholders as a last resort
    - Alternatives available?
  - necessity for other powers to be effective and to limit the losses of policyholders
  - Insurance guarantee schemes
    - Cf. ECJ, joined cases C-18/15P to C-10/15-P, *Ledra advertising Ltd and Others v European Commission and European Central Bank*, 20 September 2016)
    - Cf. EIOPA Consultation Paper on Proposals for Solvency II 2020 Review Harmonisation of National Insurance Guarantee Schemes (national IGS, minimum harmonisation, minimum coverage level, national persons and small legal entities, etc.)

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Proportionality



- enforcement of principle of proportionality
  - divergences between Member States' implementation and industry dissatisfaction
  - thresholds for exclusion from SII application
    - retention of Article 4, Solvency II, but:
      - doubling of technical provisions thresholds from 25 mln to 50 mln
      - MS option to increase the premium income threshold from 5 mln to 25 mln
  - reinforcement of proportionality across all three pillars
    - quantitative:  
simplified calculation of standard formula, calculation of counterparty default risk module, immaterial risks
    - qualitative:  
Improvement of system of governance requirements (combination of key functions, frequency of ORSA, flexibility with regard to the frequency of written policies review and assessment of administrative body), pre-emptive recovery and resolution planning
    - reporting and disclosure:  
risk-based supervisory reporting package, revision of the risk-based thresholds, simplification of quarterly submission, deletion and simplification of templates



## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Discussion of selected topics



- other topics
  - changes to the SCR and MCR
  - propriety assessments
    - possibility of joint assessment in complex cross-border cases
  - freedom to provide services and freedom of establishment
    - Exchange of information between supervisory authorities
  - macro-prudential policy
    - ORSA
    - systemic risk and liquidity risk management plans
    - capital surcharge for systemic risk
    - concentration thresholds
    - pre-emptive recovery and resolution plans + policy freezes
    - IAIS Common Framework for the Supervision of Internationally Active Insurance Groups?
  - etc.

## 2.2. EIOPA Consultation Paper on Solvency II 2020 Review – Key takeaways



- comprehensive reform - no revolution
  - regulatory focus remains on portfolio transfer as a tool for risk prevention and management of stress situations
  - harmonisation of recovery and resolution
  - pre-emptive recovery and resolution planning and reporting may lead to:
    - increased costs for run-off portfolios
    - reassessment of business strategy (focus on core business?)
- amount of run-off transactions expected to increase

# Should I submit comments to EIOPA's 2020 SII Review Consultation?



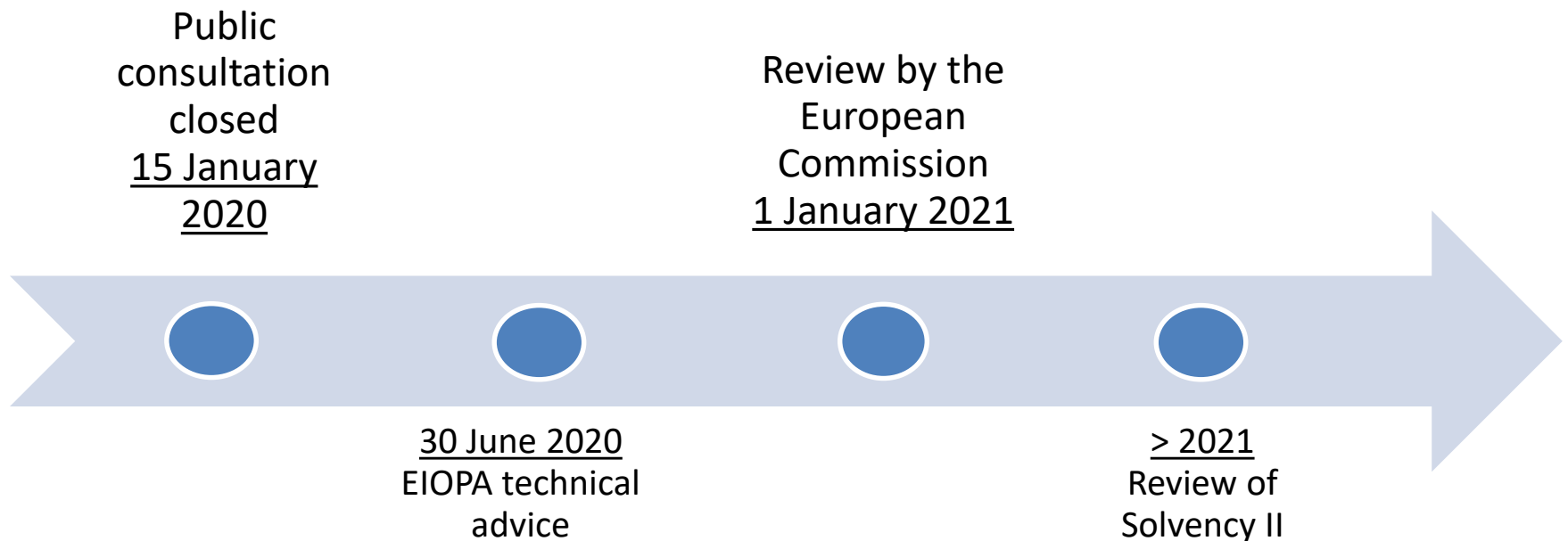
➤ Yes!

➤ importance of replies to EIOPA Consultation:

- sharing of experience
- description of nature of legacy insurers and their challenges
- importance of orderly run-off and legacy expertise for financial stability
- importance of proportionality
- *“educate the regulator”*
- possibility to make concrete proposals to facilitate run-off business

## 2.3. What's next?

- Respondents must submit replies via [eiopa.europa.eu](https://eiopa.europa.eu) before 15 January 2020



# Q&A

## Contact details



**Sandra Lodewijckx**

Partner

Insurance and Reinsurance

+32 2 787 90 33

[sandra.lodewijckx@lydian.be](mailto:sandra.lodewijckx@lydian.be)



**Alexander Hamels**

Associate

Insurance and Reinsurance

+32 2 787 90 22

[alexander.hamels@lydian.be](mailto:alexander.hamels@lydian.be)

### Brussels Office



Tour & Taxis  
Havenlaan 86C b113  
1000 Brussels  
T +32 2 787 90 00  
F +32 2 787 90 99

### Antwerp Office



Arenbergstraat 23  
2000 Antwerp  
T +32 3 304 90 00  
F +32 3 304 90 19

### Hasselt Office



Thonissenlaan 75  
3500 Hasselt  
T +32 11 260 050  
F +32 11 260 059



Stay in touch and join us at:

[LinkedIn](#)

[info@lydian.be](mailto:info@lydian.be)

[www.lydian.be](http://www.lydian.be)

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