Chapter 12

# Undertakings in Difficulty

## Introduction

Undertakings in difficulty, in the context of Solvency II, refers to insurers that are either failing or likely to fail to meet their SCR or their MCR. For a more in-depth review of the capital requirements that apply to (re)insurers, please see Chapter 8: Capital Requirements.

This chapter explores the legislative and regulatory framework that applies to (re)insurers facing difficulty complying with their capital requirements, including the consequences of noncompliance, and what enforcement and punitive powers regulatory authorities have to deal with actual or threatened noncompliance.

## 1. The Applicable Framework

### The European Framework

In situations where a (re)insurer is unable to meet its capital requirements, it must inform the relevant supervisory authority and adopt a recovery plan (in case of noncompliance with the SCR)[579] or a finance scheme (in case of noncompliance with the MCR).[580] In these situations, Article 141 of the Solvency II Directive empowers supervisory authorities "to take all measures necessary" to protect policyholders of (re)insurance contracts or the obligations stemming from reinsurance contracts.

If the (re)insurer's solvency situation continues to deteriorate, to the extent that it continues to fail to meet its MCR, the supervisory authority may be allowed to withdraw a (re)insurer's authorisation.[581] More detail on the circumstances under which a (re)insurer's authorisation can be withdrawn is set out below in "Withdrawal of Authorisations".

The Level 2 Delegated Regulation sets out detailed requirements for applying the relevant provisions of the Solvency II Directive, such as the criteria to take into account when considering extensions of the recovery period, as defined below.[582] These are supplemented by the EIOPA Guidelines on the extension of the recovery period in exceptional adverse situations (EASs) (EIOPA-BOS-15/108 EN) (Recovery Guidelines). In order to standardise enforcement actions across all member states, the EIOPA released a supervisory statement outlining supervisory expectations in respect of SCR breaches (EIOPA SCR Breach SS).[583]

The key provisions governing undertakings in difficulty are contained in Chapter VII (Articles 136 to 144) of the Solvency II Directive. Per Article 136 of the Solvency II Directive, (re)insurers must have procedures in place to identify deteriorating financial conditions and must immediately notify the supervisory authorities when such deterioration occurs. Supervisory authorities are under a similar obligation to have monitoring tools in place enabling them to identify deteriorating financial conditions in the (re)insurers they supervise and to monitor how that deterioration is remedied.[584]

[579] Article 138(2) of the Solvency II Directive.

[580] Article 139(2), *ibid.*

[581] Article 144(1), *ibid.*

[582] Articles 288 to 289 of the Level 2 Delegated Regulation.

[583] The EIOPA "Supervisory Statement on Supervisory Practices and Expectations in Case of Breach of the Solvency Capital Requirement" published in July 2021.

[584] Article 36(3) of the Solvency II Directive.

### The UK Framework

Chapter VII of the Solvency II Directive has been implemented by the UK through a number of statutory and regulatory instruments including the FSMA and the PRA Rulebook.[585]

The Level 2 Delegated Regulation is also directly applicable in the UK, having effect as retained EU legislation as of 31 December 2023. Sections 206A and 55J of the FSMA enable the FCA and the PRA to withdraw or vary an insurance undertaking's authorisation in situations where they are facing prolonged difficulty.

In a 2015 PRA SS (PRA SS17/15), the PRA sets out its approach toward withdrawing authorisations who breach their MCR obligations and where (i) the proposed finance scheme is inadequate, or (ii) the firm fails to comply with the terms of the approved finance scheme within three months of initial noncompliance with the MCR.[586]

## 2. Breaches of the Solvency Capital Requirement

### Notification Requirement

(Re)insurers are required to promptly notify the relevant supervisory authority if they either (i) become noncompliant with the SCR or (ii) identify a risk of noncompliance with the SCR within the next three months.[587] Although there is limited guidance on the probability threshold that necessitates this notification, it is crucial to understand that even the mere presence of a risk of noncompliance is sufficient to trigger the notification obligation.

### The Recovery Period

Once the relevant authorities have been informed that a (re)insurer is either noncompliant or at risk of noncompliance with the SCR over the next three months (being an undertaking in difficulty), the undertaking in difficulty enters a phase of close monitoring and supervision by the relevant supervisory authority. During this period, the relevant supervisory authorities will mandate that the undertaking in difficulty implements all necessary measures to achieve compliance within six months from the date noncompliance was observed (recovery period).[588]

The EIOPA SCR Breach SS clarifies that the date of observation of noncompliance is either (i) the date on which noncompliance with the SCR has been observed and communicated to the supervisory body, or (ii) the date indicated by the supervisory body in its notification to the undertaking in difficulty. The latter scenario occurs when the noncompliance is first detected by the supervisory authority. Compliance can be achieved through the reestablishment of the level of eligible own funds covering the SCR or a reduction of risk profile to ensure compliance with the SCR.[589]

[585] Undertaking in Difficulty Part of the PRA Rulebook.

[586] "Solvency II: Supervision of Firms in Difficulty or Run-Off", Bank of England Prudential Regulation Authority, March 2015.

[587] Article 138(1) of the Solvency II Directive (transposed in Paragraph 3.1, Undertakings in Difficulty Part of the PRA Rulebook).

[588] Article 138(3), *ibid* (transposed in Paragraph 3.1, Undertakings in Difficulty Part of the PRA Rulebook).

[589] *Ibid.*

## The Recovery Plan

Within two months of the observation of actual or risked noncompliance with the SCR, an undertaking in difficulty must submit a recovery plan for approval by its relevant supervisory authority.[590] It is worth noting that a recovery plan is not required if the undertaking in difficulty adopts prompt recovery measures which (i) restore its compliance with the SCR within two months, and (ii) these measures are considered adequate by the relevant supervisory authority.[591]

If required, the recovery plan must include the following:

- Estimates of management expenses, in particular current general expenses and commissions.
- Estimates of income and expenditure in respect of direct business, reinsurance acceptances and reinsurance cessions.
- A forecast balance sheet.
- Estimates of the financial resources intended to cover the technical provisions and the capital requirements.
- The firm's overall reinsurance policy.[592]

The EIOPA SCR Breach SS provides further guidance on the contents and preparation of the recovery plan, which should take into account (i) the level of noncompliance with the SCR, and (ii) the possible duration of the undertaking in difficulty's deteriorated financial condition. The EIOPA SCR Breach SS further stresses that the recovery plan must be based on "realistic and timely recovery" measures, having assessed their feasibility,[593] and include a comprehensive implementation plan, with a clear delineation of specific actions and timelines for each step.[594]

## Initial Extensions to the Recovery Period

The Solvency II Directive mandates that undertakings in difficulty must reestablish compliance with the SCR within six months from the point of noncompliance. However, supervisory authorities have the discretion to extend this recovery period by an additional three months, making the total possible period nine months.[595]

The UK's extension regime remains for now closely aligned with that of the EU. The PRA grants undertakings in difficulty a six-month period to reestablish compliance with the SCR.[596] The PRA also has the option to extend this period by an additional three months.[597]

[590] Article 138(3), *ibid* (transposed in Paragraph 3.1, Undertakings in Difficulty Part of the PRA Rulebook).

[591] The EIOPA, "EIOPA Supervisory Statement on the Supervisory Practices and Expectations in Case of Breach of the Solvency Capital Requirement".

[592] Article 142(1) of the Solvency II Directive (transposed in Paragraph 5.1, Undertakings in Difficulty Part of the PRA Rulebook).

[593] Paragraph 3.7 of the EIOPA SCR Breach SS.

[594] Paragraph 3.15, *ibid*.

[595] Article 138(3) of the Solvency II Directive.

[596] Paragraph 3.1, Undertakings in Difficulty Part of the PRA Rulebook.

[597] Regulation 4A(1) of the Solvency 2 Regulations 2015.

## Further Extensions to the Recovery Period – The UK Regime

Notwithstanding the above, the PRA in the UK is able to extend the initial six-month recovery period by a maximum of seven years, following a declaration of existence of an EAS by the Prudential Regulation Committee of the Bank of England.[598] An EAS exists where the financial situation of (re)insurers representing a significant share of the market or of the affected lines of business are seriously or adversely affected by one or more of the following conditions:

- A fall in financial markets that is unforeseen, sharp and steep.
- A persistent low interest rate environment.
- A high-impact catastrophic event.[599]

The Prudential Regulation Committee of the Bank of England must regularly assess whether the aforementioned conditions still apply and accordingly must declare when the EAS has ceased.[600]

To declare an EAS the Prudential Regulation Committee of the Bank of England must take into account the following factors:

- The impact of possible subsequent decisions by supervisory authorities to extend the recovery period, on financial markets, on the availability of insurance and reinsurance products and on policyholders and beneficiaries.
- The number, size and market share of the (re)insurers affected by the EAS and whether the size and nature of those undertakings could, when taken together, have a negative effect on the financial markets or on insurance and reinsurance markets.
- Possible pro-cyclical effects of reestablishing compliance with the SCR, including distressed sales of assets on financial markets.
- The possibility for (re)insurers to raise additional own funds in financial markets.
- The availability of an active market for assets held by (re)insurers and the liquidity of that market.
- The capacity of the reinsurance market to provide reinsurance or retrocession cover.
- The availability in financial markets of adequate risk mitigation techniques, including financial instruments.
- The availability in financial markets of other means to reduce the risk exposure of (re)insurers.[601]

The mere declaration of existence of an EAS does not automatically entitle any undertaking to an extension of the recovery period.[602] The particular undertaking must be impacted by the situation, and, in making this determination, supervisory authorities must take into account factors mentioned above, as well as the following factors specific to the undertaking in difficulty:

- The impact of an extension on policyholders and beneficiaries of the undertaking.
- The extent to which the (re)insurer is affected by the EAS.

[598] Regulation 4A(3), *ibid.*

[599] *Ibid.*

[600] Regulation 4A(4)-(5), *ibid.*

[601] Article 288 of the Level 2 Delegated Regulation.

[602] The Recovery Guidelines.

- The means available to the undertaking to reestablish compliance with the SCR and the existence of a realistic recovery plan.
- The causes and the degree of noncompliance with the SCR.
- The composition of own funds held by the (re)insurer.
- The composition of the assets held by the (re)insurer.
- The nature and duration of technical provisions and other liabilities of the (re)insurer.
- When applicable, the availability of financial support from other undertakings of the group to which the (re)insurer belongs.
- Any measures taken by the (re)insurer to limit the outflow of capital and the deterioration of its solvency position.[603]

The Recovery Guidelines contain further guidance on the factors and considerations to be taken into account when considering an application for an extension of the recovery period. The PRA has indicated that the Recovery Guidelines are part of a non-exhaustive list of EIOPA guidelines that are complied with in the UK.[604] The Recovery Guidelines also mandate that any decision to extend the recovery period must include a provision allowing the supervisory authority to revoke or shorten the extended period if the circumstances that justified the extension have changed. Under such new circumstances, the supervisory authority might not have approved the extension or might have approved a shorter extension.[605] In the context of the UK, where the Prudential Regulation Committee of the Bank of England declares that the EAS no longer exists, the PRA should promptly reassess any granted extensions.

## Further Extensions to the Recovery Period – The EU Regime

For EU (re)insurers, supervisory authorities are able to extend the initial recovery period by a maximum period of seven years, provided the EIOPA has made a declaration of existence of an EAS, after having made the requisite consultation with the European Systemic Risk Board.[606]

The Solvency II Directive empowers the EIOPA to declare the existence of an EAS following a request by the supervisory authority concerned. It must to do so in accordance with the conditions mentioned in Article 138(4) of the Solvency II Directive, which are the same as set out above for the UK regime. In deciding whether to declare the existence of an EAS and whether a particular (re)insurer is impacted by the situation, thus warranting an extension, the EIOPA takes into account the same general and specific conditions as considered under the UK regime and stipulated in the Level 2 Delegated Regulation.

One of the Amendments (discussed in previous chapters) acts upon the advice of the EIOPA in the EIOPA Opinion on the 2020 Review of Solvency II (EIOPA-BoS-20/749) (EIOPA Opinion), suggesting that Article 138(4) be amended to clarify that the responsibility for consulting the European Systemic Risk Board is one for the EIOPA when considering whether to declare an EAS and not one for supervisory authorities when deciding on whether to declare an extension to the recovery period.

[603] Article 289 of the Level 2 Delegated Regulation.

[604] "Appendix 1: Non-exhaustive List of EIOPA Guidelines That Are Complied With in the UK", PRA Rulebook.

[605] Guideline 2, Paragraph 1.15 of the Recovery Guidelines.

[606] Article 138(4) of the Solvency II Directive.

The Recovery Guidelines clarify that the rationale behind the power to extend the recovery period is to provide supervisory authorities with flexibility in a situation where a significant part of the insurance market faces major problems that could lead to serious repercussions for the market as a whole. As such, the Recovery Guidelines require supervisory authorities to balance macroprudential considerations against the need to protect policyholders and beneficiaries of the concerned (re)insurer. When deciding on an extension, supervisory authorities should aim to prevent disproportionate negative effects for the financial market in general or the (re)insurance market in particular.

### Progress Reports and Withdrawals of Extensions

Where an extension to the recovery period has been granted, the concerned (re)insurer must submit a progress report to the supervisory authority every three months, setting out any specific measures taken and the progress made toward reestablishing the level of eligible own funds covering the SCR or to reduce the risk profile to ensure compliance with the SCR.[607] According to the EIOPA SCR Breach SS, (re)insurers should notify supervisory authorities of any significant change in the extent of the solvency or liquidity shortfall following submission of the recovery plan.

Importantly, the supervisory authority must withdraw any granted extension where the submitted progress report shows that there was "no significant progress" in reestablishing the level of eligible own funds covering the SCR or the reduction of the risk profile to ensure compliance with the SCR between the date of the observation of noncompliance and the date of the submission of the progress report.[608]

In assessing whether "significant progress" has been made toward compliance with the SCR, the inquiry is primarily focused on whether the (re)insurer is still likely to meet its recovery plan. As part of this assessment, the supervisory authority should consider whether the (re)insurer: "failed without sufficient justification to implement any measures it has committed itself to take; or failed in making significant progress on any of the objectives to be achieved in every three months as a result of the proposed measures that were included in the recovery plan".[609]

If, following consideration of the factors set out above, the supervisory authority concludes that the extension of the recovery period should be withdrawn, the (re)insurer should be given an opportunity to make submissions on the proposed withdrawal within an appropriate timeframe.[610] Where the supervisory authority withdraws the extension, it must make sure that the concerned (re)insurer publicly discloses this information, along with the reasons for the withdrawal, without delay.[611]

## 3. Breaches of the Minimum Capital Requirement

(Re)insurers are required to promptly notify the supervisory authority as soon as they detect either (i) noncompliance with the MCR or (ii) a potential risk of noncompliance with the MCR within the next three months.[612] Although there is limited guidance on the probability threshold that necessitates this notification, it is important to note that a mere risk of noncompliance alone triggers the notification requirement.

[607] Article 138(4), *ibid* (transposed in Paragraph 3.2, Undertakings in Difficulty Part of the PRA Rulebook).

[608] Article 138(4), *ibid* (transposed in Regulation 4A(6) of the Solvency 2 Regulation 2015).

[609] Guideline 9 of the Recovery Guidelines.

[610] Guideline 10, *ibid*.

[611] (1) Article 54(1) of the Solvency II Directive; and (2) Guideline 11 of the Recovery Guidelines.

[612] Article 139(1) of the Solvency II Directive (transposed in Paragraph 4.1, Undertakings in Difficulty Part of the PRA Rulebook).

Within one month of identifying noncompliance with the MCR, an undertaking in difficulty must submit a short-term, realistic financial plan for approval by the supervisory authority.[613] This financial plan should aim either to restore the eligible BOF to at least the MCR level or reduce the company's risk profile to ensure MCR compliance within three months of the noncompliance observation (MCR recovery period).[614] Unlike the situation with noncompliance with the SCR, there are no extensions available for the MCR recovery period.

Certain Amendments, as previously mentioned, address proposals from the EIOPA Opinion. These Amendments specify that any noncompliance with the MCR must be reported immediately, rather than waiting for the quarterly reporting period, which is the current practice in some member states. Additionally, they require that a finance scheme be submitted when there is a risk of noncompliance, not just when noncompliance has already occurred. These Amendments have not yet come into effect.

Articles 218 and 230 of the Solvency II Directive clarify that the Directive's rules regarding deteriorating financial conditions and noncompliance with the capital requirements apply equally on a group solvency basis. This means that if a group fails to meet its capital requirements, it must prepare a recovery plan or finance scheme in the same manner as an individual (re)insurer.

## 4. Consequences of Noncompliance — Regulatory Powers

Article 141 of the Solvency II Directive gives supervisory authorities the general power, in situations where the solvency of the (re)insurer continues to deteriorate, "to take all necessary measures to safeguard the interests of policy holders in the case of insurance contracts, or the obligations arising out of reinsurance contracts". Any measures taken in respect of Article 141 should be proportionate to the level and duration of the deterioration of the solvency position of the undertaking in difficulty concerned. In the UK, the PRA has powers under FSMA to, for a period it considers appropriate, suspend a (re)insurer's permission or impose such limitations or other restrictions that it considers appropriate.[615]

The EIOPA SCR Breach SS encourages supervisory authorities to impose additional measures on the (re)insurer if compliance with the SCR is not restored within the recovery period. These measures should be proportionate and should take into account (i) the level of noncompliance with the SCR, (ii) the duration of the deterioration of the undertaking's financial conditions and (iii) the sustainability of the applied measures by the (re)insurer to restore its solvency. Where there has been no improvement in noncompliance or the measures in place will not allow the recoverability of the solvency position in a sustainable manner protecting interests of all policyholders, supervisory authorities are encouraged to consider withdrawing the (re)insurer's authorisation.

Aside from the aforementioned general authority, there are some specific powers at supervisory authorities' disposal, discussed below.

613 *Ibid.*

614 Article 139(2), *ibid* (transposed in Paragraph 4.1, Undertakings in Difficulty Part of the PRA Rulebook).

615 Sections 206A and 55M of the FSMA.

## Withholding Solvency Certification

Where an undertaking in difficulty fails to submit a recovery plan for noncompliance with its SCR (under Article 138(2)) or a finance scheme for noncompliance with its MCR (under Article 139(2)), supervisory authorities must refrain from issuing a solvency certificate, in accordance with Article 39 of the Solvency II Directive. The solvency certificate can be withheld as long as the supervisory authority considers that the rights of the policyholders, or the contractual obligations of the reinsurer, are threatened.[616]

## Restricting Free Disposal of Assets

The Solvency II Directive gives supervisory authorities the power to restrict or prohibit the free disposal of a (re)insurer's assets in the following circumstances:

- In the event of noncompliance with the SCR, where (i) exceptional circumstances exist, and (ii) the supervisory authority is of the opinion that the financial situation of the (re)insurer concerned will deteriorate further.[617]
- In the event of noncompliance with the MCR.[618] It should be noted that the Amendments state that if a winding-up proceeding is not opened with respect to the (re)insurer within two months of notification on noncompliance or risk of noncompliance to the supervisory authority, the supervisory authority may restrict free disposal of assets in the event of noncompliance with the MCR.
- In the event of noncompliance with technical provisions.[619]

If a supervisory authority restricts or prohibits the free disposal of an undertaking's assets in the event of noncompliance with the SCR or MCR, as mentioned above, it must notify the supervisory authorities of host member states about the measures it has taken. Those host supervisory authorities, upon request from the initial authority that imposed the restrictions, are required to implement equivalent measures.[620]

In cases where a supervisory authority restricts or prohibits the free disposal of a (re)insurer's assets in the event of noncompliance with technical provisions, it must first communicate its intentions to the supervisory authorities of the host member states before taking any action.[621]

In all instances, it is the supervisory authority of the home member state that will designate the specific assets to be covered by such measures.

## Withdrawal of Authorisations

The supervisory authority of the home member state must withdraw a (re)insurer's authorisation where the (re)insurer does not comply with the MCR and the supervisory authority considers that the finance scheme submitted is manifestly inadequate or the (re)insurer concerned fails to comply with the approved scheme within three months from the observation of noncompliance with the MCR.[622] Any decision to withdraw an authorisation must be communicated to the (re)insurer with full reasons.[623]

[616] Article 142(2) of the Solvency II Directive.
[617] Article 138(5), *ibid.*
[618] Article 139(3), *ibid.*
[619] Article 137, *ibid.*
[620] Articles 138(5) and 139(3), *ibid.*
[621] Article 137, *ibid.*
[622] Article 144(1), *ibid.*
[623] Article 144(3), *ibid.*

There are certain circumstances under which the supervisory authority of the home member state may withdraw a (re)insurer's authorisation, as listed in Article 144(1) of the Solvency II Directive:

- The (re)insurer concerned does not make use of the authorisation within 12 months, expressly renounces it or ceases to pursue business for more than six months, unless the member state concerned has made provision for authorisation to lapse in such cases.
- The (re)insurer concerned no longer fulfils the conditions for authorisation.
- The (re)insurer concerned fails seriously in its obligations under the regulations to which it is subject.

When an authorisation is withdrawn, the supervisory authority of the home member state must inform the supervisory authorities of other member states. These authorities are then required to take appropriate measures to prevent the (re)insurer from commencing new operations within their territories. Additionally, the supervisory authority of the home member state, in collaboration with other supervisory authorities, must take all necessary measures to safeguard the interests of policyholders. This may include exercising the power to restrict the free disposal of the (re)insurer's assets.[624]

The PRA's equivalent power of varying or cancelling a (re)insurer's Part 4A permission is found in Section 55J of the FSMA. The PRA has broad power to cancel a (re)insurer's permission where there has been a serious failure to comply with the requirements imposed by or under FSMA. Additionally, the PRA is obligated to vary a (re)insurer's permission if it fails to comply with the SCR or MCR and either:

- Has failed to submit a finance scheme.
- Has submitted a finance scheme that is manifestly inadequate.
- Has failed to comply with the approved finance scheme within a period of three months from the date it first became aware of noncompliance with the appropriate capital requirement to which the scheme relates.[625]

If any of the aforementioned conditions apply, the PRA is obligated to vary the (re)insurer's permission to remove the regulated activity of effecting insurance contracts as principal.[626]

However, the PRA is not required to withdraw permission to carry out the separate regulated activity of administering insurance contracts unless it is deemed necessary to protect the interests of the (re)insurer's policyholders.[627] The rationale behind this approach is detailed in the PRA SS17/15. While the PRA acknowledges the need to close business rapidly and orderly when there is no realistic prospect of prompt compliance with the MCR, it also recognises that, in many circumstances, a run-off strategy may be in the best interests of policyholders, regardless of whether the firm is solvent or insolvent.

In such situations, the current FSMA framework does not allow a firm in this position "to effect new contracts of insurance but the firm may be permitted to carry out existing contracts in a manner, and for so long as, the PRA considers necessary in order to afford an appropriate degree of protection to policyholders". [628]

If the effect of a variation is to remove all regulated activities to which the Part 4A permission relates, the PRA must instead cancel the permission.[629]

[624] Article 140, *ibid.*

[625] Sections 55J(7B) and 55KA of the FSMA.

[626] Section 55J(7B)(a), *ibid.*

[627] Section 55J(7B)(b), *ibid.*

[628] Paragraph 2.5 of the PRA SS17/15.

[629] Section 55J(7C) of the FSMA.

## 5. Introducing Recovery and Resolution Procedures

### The EU Framework

Currently, there are no harmonised procedures in the EU or UK for the recovery and resolution of insurers, although similar frameworks exist in the banking sector. In the EIOPA Opinion, the EIOPA recommended establishing a minimum harmonised EU recovery and resolution framework for insurers and reinsurers.

The journey towards establishing a recovery and resolution framework began in September 2021, when the European Commission published a legislative proposal for the Insurance Recovery and Resolution Directive (IRRD). In December 2023, the Council of the European Union and the European Parliament reached a provisional political agreement on the latest official text of the IRRD, which was subsequently published in January 2024.

In April 2024, the European Parliament voted in a plenary session to adopt the IRRD which the European Council officially adopted on 5 November 2024. The IRRD will enter into force 20 days after its publication in the Official Journal. Member states will be required to implement the IRRD into national law within 24 months and one day after its entry into force.

The IRRD will create a legislative framework for the recovery and resolution of EU (re)insurers and their groups. It adopts a preemptive approach, requiring (re)insurers to submit recovery plans to supervisory authorities as part of their regular reporting process. These authorities will be granted powers to implement resolutions.

A key distinction from the Solvency II framework is that IRRD preemptive recovery plans are not required when a (re)insurer is noncompliant with its SCR. Some of the key elements of the IRRD regime are as follows:

- The IRRD will apply to all (re)insurers that are established in the European Union. Notably, certain small and non-complex (re)insurers are excluded from the preemptive recovery plans and resolution planning framework, except where such a (re)insurer represents a particular risk at national or regional level. The IRRD mandates member states to establish one or more resolution authorities that will be empowered to apply resolution tools and exercise the resolution powers.
- (Re)insurers that are not part of a group will be required to prepare and submit preemptive recovery plans to the supervisory authorities, which should be updated regularly. For groups, the ultimate parent undertaking must draw up and submit a group preemptive recovery plan. Importantly, supervisory authorities can decide which (re)insurers are to be subject to the IRRD requirements by considering the following factors: size, business model, risk profile, interconnectedness, substitutability and importance for the economy of the member state. However, it must be ensured that at least 60% of the member state's life and non-life insurance and reinsurance market are subject to preemptive recovery planning requirements pursuant to the IRRD.[630]
- The preemptive recovery plans must contain the following:[631]
  - A summary of the key elements of the plan.
  - A summary of any changes to the (re)insurer since their most recent filing.

[630] Article 5(2) of the IRRD.

[631] Article 5(6), *ibid.*

  - A description of the (re)insurer or the group.
  - A recovery indicator framework.
  - A description of how the preemptive recovery plan has been drawn up, how it will be updated and how it will be applied.
  - A range of remedial actions.
  - A communication strategy.
  - Where a recovery plan had been submitted under Article 138(2) of the Solvency II Directive, that recovery plan as well as an assessment of the measures taken to restore the (re)insurer's compliance with the SCR.
- Resolution authorities will have to prepare resolution plans for selected (re)insurers, based on similar eligibility criteria to those used for recovery planning (aforementioned). It should be ensured, however, that at least 40% of the member state's life and non-life (re)insurance market must be subject to resolution planning.[632] Group resolution authorities will responsible for drawing up group resolution plans. The IRRD details specifics to be included in the resolution plans, which includes, on a broad level, resolution actions to be undertaken if certain conditions of resolution (discussed below) are met.
- At the same time resolution authorities are drawing up or updating resolution plans, they will be have to conduct resolvability assessments for a group or individual insurer: *i.e.*, assess the extent to which an insurance group is resolvable without any extraordinary public support.[633] To the extent that it has received a notification from the resolution authority that there is a substantive impediment to the resolvability of a (re)insurer, the relevant (re)insurer will have four months to propose alternate possible measures or remove the impediments identified by the resolution authority.[634]
- The conditions for resolution action, alluded to above, are as follows:
  - The (re)insurer is failing or likely to fail.
  - There is no reasonable prospect that any alternative private sector measures or supervisory action, including preventive and corrective measures, would prevent the failure of the (re)insurer within a reasonable timeframe.
  - Resolution action is necessary in the public interest.[635]
- The resolution tools that can be used by the resolution authorities, in the event the aforementioned resolution conditions are met, are as follows:
  - The solvent run-off tool: place the (re)insurer in a solvent run-off procedure to terminate the activities of that (re)insurer, and withdraw its authorisation to underwrite new insurance and reinsurance business.
  - The asset and liability separation tool: transfer of impaired or problem assets or liabilities (or both) to a management vehicle to allow them to be managed and worked out over time — this tool can only be used in conjunction with another tool.
  - The sale of business tool: sale of all or part of a (re)insurer's business.

[632] Article 9(2), *ibid.*
[633] Article 13(1), *ibid.*
[634] Article 15(3), *ibid.*
[635] Article 19(1), *ibid.*

- The bridge undertaking tool: transfer of all or part of a (re)insurer's business to a publicly controlled entity, with the idea to sell the business to a private purchaser when market conditions are appropriate.
- The write-down or conversion tool: write-down or conversion of capital instruments, debt instruments and other eligible liabilities.[636]

## The UK Framework

HM Treasury has proposed a framework for pre-resolution planning that is broadly similar to the EU regime.[637] The proposed regime is preemptive, requiring resolution plans and assessments of resolvability in advance, with the Bank of England serving as the resolution authority. This new resolution authority will determine whether an insurer is failing or likely to fail and should therefore be subject to its stabilisation powers. The scope of the UK regime is intended to be broad, covering all UK-authorised insurers in principle. HM Treasury has indicated that, in practice, only a subset of insurers, such as those providing critical functions, will be subject to the regime.

Similar to the EU regime, the HM Treasury proposal includes specific resolution conditions that must be satisfied before stabilisation tools can be utilised. These conditions are as follows:

- The insurer is failing or is likely to fail.
- It is not reasonably likely that other actions (excluding stabilisation powers) will be taken to prevent the insurer from failing.
- Employing stabilisation powers is necessary in the public interest.
- One or more of the statutory resolution objectives would not be met to the same extent if stabilisation powers were not used.

Once the resolution conditions are satisfied, the proposed regime introduces stabilisation options that can be deployed in respect of a failing insurer. These are broadly similar to those under the EU regime and include:

- Transfer of an insurer's shares or assets to a private purchaser.
- Establishing a bridging institution to allow additional time for a prospective purchaser to perform due diligence and valuation while the insurer maintains critical functions.
- Restructuring, modifying, limiting or writing down the failing insurer's liabilities in order of creditor preference (including insurance liabilities) so the insurer's capital coverage can be restored to a sufficient level to allow a solvent run-off.
- As a last resort and temporary measure, temporary public ownership.

In addition, the resolution authority will have the power to establish an asset management vehicle for the run-down of non-performing or difficult-to-value assets. It will also be able to carry out insurance administration procedures. These capabilities will enable the resolution authority to use its stabilisation tools while ensuring the continued operation of the insurer's critical functions.

[636] Article 26(3), *ibid.*

[637] HM Treasury "Consultation, Introducing an Insurer Resolution Regime", January 2023.

The proposal also contains provisions for pre-resolution planning. For example, insurers will need to conduct ongoing recovery and resolution planning, which should set out the proposed resolution strategy for the insurers and an operational plan for implementation, including what stabilisation powers will be applied and how. The plans will need to be updated annually or more frequently if there are changes to the firm's structure, strategy or operating condition.

## 6. Proposed UK Exit Planning Regime

On 23 January 2024, the PRA published a PRA CP on solvent exit planning for insurers in the UK.[638] The PRA also published a draft PRA SS setting out its expectations for UK insurers to prepare, as part of their BAU activities, for a solvent exit.[639] The PRA defines a solvent exit as the process through which a firm ceases its insurance business in an orderly manner while remaining solvent throughout. The regime will apply to all UK insurers except for firms in passive run-off and UK branches of overseas insurers.

Under the proposed regime, firms will have to prepare for an orderly solvent exit as part of their BAU activities by producing a Solvency Exit Analysis (SEA), regardless of how unlikely or distant a prospect solvent exit may seem to the firm. The level of detail in the plan should be proportionate to the nature, scale and complexity of the firm.[640] At a minimum, the SEA will have to include solvent exit actions (*i.e.*, how the firm would carry out a solvent run-off of its liabilities), solvent exit indicators (*i.e.*, when it may need to initiate a solvent exit), potential barriers and risks, resources and costs to execute a solvent exit, a communications strategy, clear governance arrangements and assurance that the SEA is approved in accordance with the firm's governance arrangements. The SEA must be updated once every three years and whenever a material change takes place.

Additionally, firms will also have to produce a Solvent Exit Execution Plan (SEEP) within one month, when there is a realistic prospect that the firm may need to execute a solvent exit (which could be informed by its solvent exit indicators). The SEEP will include sufficient detail on how the firm will complete the cessation of its PRA regulated activities. The SEEP should be guided by the SEA and should be appropriate to a firm's s business model, structure, operations, risk strategy and circumstances leading to the initiation of a solvent exit. In particular, the SEEP should set out: (i) how the firm will monitor, and respond to, any emerging barriers and risks throughout the execution of a solvent exit; (ii) details of the financial and non-financial resources needed to execute a solvent exit; and (iii) a clear and detailed communication plan for stakeholders.

## 7. Introducing Macroprudential Tools

The Amendments will introduce targeted macroprudential rules, which are aimed at ensuring (re)insurers have adequate liquidity to settle their financial obligations towards policyholders and other counterparties when they fall due, even under stressed conditions. The key features of these rules are as follows:

- A newly inserted Article 144a will require (re)insurers to prepare and update a liquidity risk management plan covering liquidity analysis over the short term. Upon the request of supervisory authorities, (re)insurers may be required to extend the liquidity analysis over medium and long term. Notably, small and non-complex undertakings will be exempt from this requirement.

[638] "Appendix 2: Draft Supervisory Statement — Solvent Exit Planning for Insurers", Bank of England PRA, January 2024.

[639] PRA CP2/24.

[640] Paragraph 2.22, *ibid.*

- Article 144b will give supervisory authorities the power to intervene where material liquidity risks are identified and no effective remedies have been taken by the (re)insurer. In particular, supervisory authorities will have the power to temporarily:
  - Restrict or suspend dividend distributions or other payments to shareholders and other subordinated creditors.
  - Restrict or suspend share buy-backs and repayment or redemption of own fund items.
  - Restrict or suspend bonuses or other variable remuneration.
  - Suspend redemption rights of life insurance policyholders.
- Article 144c will introduce supervisory powers to preserve solvency during periods of exceptional sector-wide shocks that have the potential to threaten the financial position of the (re)insurer concerned or the stability of the financial system. These powers are the same as the Article 144b powers aforementioned. The EIOPA will be empowered, after consultation with the European Systemic Risk Board, to develop draft regulatory technical standards to specify the criteria for the identification of exceptional sector-wide shocks.