



EIOPA-BoS-14/177 EN

Guidelines on loss-absorbing capacity of technical provisions and deferred taxes

Introduction

- 1.1. According to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority ("EIOPA Regulation")¹ EIOPA has drafted Guidelines on the loss-absorbing capacity of technical provisions and deferred taxes.
- 1.2. The Guidelines relate to Articles 103(c) and 108 of Directive 2009/138/EU 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)² as well as to Article 83 and Articles 205 to 207 of Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC (hereinafter "Commission Delegated Regulation 2015/35")³.
- 1.3. These Guidelines are addressed to supervisory authorities under Solvency II.
- 1.4. The following Guidelines are intended to establish consistent, efficient and effective supervisory practices and to ensure the common, uniform and consistent application of Union law on the calculation of the adjustments for the loss-absorbing capacity of technical provisions and deferred taxes to the Solvency Capital Requirement.
- 1.5. Guidelines 1 to 14 apply, on a solo basis, to insurance and reinsurance undertakings using the standard formula and where relevant, also to groups using the standard formula.
- 1.6. Guidelines 15 to 22 apply to groups using the standard formula and when method 1 is used, either exclusively or in combination with method 2. When method 2 is used exclusively, Guidelines 15 to 22 do not apply since the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes is not done additionally at group level. When the combination of methods is used, the Guidelines apply only to the consolidated part of the group.
- 1.7. The Guidelines do not cover the valuation of technical provisions or deferred tax assets and liabilities in the Solvency II balance sheet, as these are covered by Article 15 of Commission Delegated Regulation 2015/35.
- 1.8. The term "deferred taxes" is used in Solvency II in two contexts: firstly to describe items on the Solvency II balance sheet and secondly, in connection with the calculation of tax adjustments to the Solvency Capital Requirement. In order to avoid confusion, the following Guidelines introduce the term "notional deferred taxes" for items used in the calculation of the adjustment.
- 1.9. For the purpose of these Guidelines, the following definition has been developed:

¹ OJ L 331, 15.12.2010, p. 48–83

² OJ L 335, 17.12.2009, p. 1-155

³ OJ L 12, 17.01.2015, p. 1-797

- 'Notional deferred taxes' refers to the sum of the products of all relevant and material tax rates and all relevant and material changes in temporary differences between Solvency II valuation and the valuation for tax purposes resulting from the instantaneous loss referred to in Article 207(1) of Commission Delegated Regulation 2015/35. In the simplest case, where there is only one tax rate and all losses contribute to a change of temporary differences, the notional deferred taxes would be represented by the product of a uniform tax rate and the loss referred to in Article 207(1) of Commission Delegated Regulation 2015/35. "Notional deferred taxes" do not represent the difference between pre- and post-stress deferred taxes⁴. An undertaking should assess which amount of the notional deferred taxes could be recognized in the Solvency II balance sheet after suffering the loss in the stress.

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

1.11. The Guidelines shall apply from 1 January 2016.

Section I: Adjustment for the loss-absorbing capacity of technical provisions

Guideline 1 - Calculation of the Basic Solvency Capital Requirement

1.12. When calculating the impact of a scenario on the basic own funds as referred to in Article 83 of Commission Delegated Regulation 2015/35 undertakings should:

- (a) keep the cash flows relating to future discretionary benefits unchanged and not rediscount them; and
- (b) where the scenario affects the risk free interest rate term structure, especially the stress on the interest rate level, rediscount only the cash flows relating to guaranteed benefits.

1.13. Undertakings should allow for the requirements set out in paragraph 1.12 when formulating future management actions as referred to in Article 83(2)(a) of Commission Delegated Regulation 2015/35.

Guideline 2 – Method for determining the capital requirement of sub-modules in the calculation of the Basic Solvency Capital Requirement

1.14. Without prejudice to Guideline 1, where the calculation of a module or sub-module of the Basic Solvency Capital Requirement is based on the impact of a scenario supervisory authorities should allow undertakings to determine its capital requirement based on the respective capital requirement derived for calculating the net Basic Solvency Capital Requirement in the following way:

⁴ An example for the concept of notional deferred taxes can be found in an Appendix to the Explanatory Text.

- (a) calculate the value of future discretionary benefits taking into account the impact of the scenario;
- (b) calculate the difference between the value of future discretionary benefits in the current Solvency II balance sheet and the value referred to in a);
- (c) add the difference in b) to the capital requirement for the module or sub-module derived for calculating the net Basic Solvency Capital Requirement.

Guideline 3 – Stress impact on future discretionary benefits in the net calculation

- 1.15. When determining the impact of a scenario on future discretionary benefits included in technical provisions referred to in Article 206(2)(b) of Commission Delegated Regulation 2015/35 undertakings should take into account:
- (a) the impact of the scenario on future profits; and
 - (b) the future management actions regarding the distribution of future discretionary benefits in response to the scenario.
- 1.16. When calculating the net Basic Solvency Capital Requirement, undertakings should allow for any stresses to the interest rate level, including any changes to the relevant risk free interest term structure used for discounting cash flows relating to future discretionary benefits.

Guideline 4 - Future bonus rates

- 1.17. Where the assumptions on future management actions following a scenario referred to in Article 206(2)(b) of Commission Delegated Regulation 2015/35 include the variation of future bonus rates, undertakings should allow in the extent of the variation for the nature and the scale of the underlying stress.

Guideline 5 - Management actions

- 1.18. Undertakings should make assumptions on future management actions regarding the distribution of future discretionary benefits that are consistent with their current business practice.
- 1.19. In the calculation of the adjustment for the loss-absorbing capacity of technical provisions undertakings should make assumptions on future management actions at a level of granularity that reflects all material and relevant legal, regulatory or contractual restrictions on the distribution of future discretionary benefits.

Section II: Adjustment for the loss-absorbing capacity of deferred taxes - calculation

Guideline 6 - Granularity of calculation

1.20. Undertakings should perform the calculation of the adjustment for the loss-absorbing capacity of deferred taxes at a level of granularity that reflects all material and relevant regulations in all applicable tax regimes.

Guideline 7 – Valuation principles and approaches

1.21. Undertakings should calculate the adjustment for the loss-absorbing capacity of deferred taxes by stressing the Solvency II balance sheet and determining the consequences on the tax figures of the undertaking. The adjustment should then be calculated on the basis of temporary differences between the stressed Solvency II values and the corresponding figures for tax purposes.

1.22. In accordance with the requirements of Article 15(1) of Commission Delegated Regulation 2015/35, undertakings should take into account all assets and liabilities that are recognized for solvency or tax purposes in the calculation of the loss-absorbing capacity of deferred taxes.

1.23. Notwithstanding paragraph 1.22, supervisory authorities should allow undertakings, when determining the tax consequences of the loss referred to in Article 207(1) of Commission Delegated Regulation 2015/35, to use an approach based on average tax rates, provided they are able to demonstrate that those average tax rates are determined at an appropriate level, and that such an approach avoids a material misstatement of the adjustment.

Guideline 8 - Loss attribution

1.24. Where undertakings use an approach based on average tax rates, they should allocate the loss referred to in Article 207(1) of Commission Delegated Regulation 2015/35 to its causes in accordance with Article 207(5) of Commission Delegated Regulation 2015/35 if the calculation of the deferred tax adjustment on an aggregate level does not reflect all material and relevant regulations of applicable tax regimes.

1.25. Where the allocation set out in paragraph 1.24 does not reflect all material and relevant regulations of applicable tax regimes, undertakings should allocate the loss to balance sheet items with a sufficient level of granularity to meet this requirement.

Guideline 9 - Arrangements for the transfer of profits or losses

1.26. Where an undertaking has entered into contractual agreements regarding the transfer of profit or loss to another undertaking or is bound by other arrangements under existing tax legislation in the member state (tax groups) or an arrangement whereby such transfer occurs or is considered to occur through an offset of such losses against profits of another undertaking under the

applicable tax consolidation rules in the Member State (fiscal unity), the undertaking should take these agreements or arrangements into account in the calculation of the adjustment for loss-absorbing capacity of deferred taxes.

- 1.27. Where it is contractually agreed and probable that a loss will be transferred to a another undertaking or where such loss transfer occurs or is considered to occur through an offset of such losses against profits of another undertaking (“receiving undertaking”) after the undertaking (“transferring undertaking”) suffers the instantaneous loss referred to in Article 207(1) of Commission Delegated Regulation 2015/35, the transferring undertaking should only recognize the related deferred tax adjustment to the extent that the payment or other benefit will be received in exchange for the transfer of notional tax losses.
- 1.28. The transferring undertaking should only recognize the payment or benefit receivable to the extent that a deferred tax adjustment could be recognized under Guideline 10 if the loss was not transferred.
- 1.29. The transferring undertaking should only recognize payment or benefits receivable if the arrangement or contractual agreement is legally effective and enforceable by the transferring undertaking with respect to the transfer of those items.
- 1.30. If the value of payment or benefit receivable is conditional on the solvency or tax position of the receiving undertaking or that of the existing tax consolidation (fiscal unity) as a whole, the transferring undertaking should base the valuation of the payment or benefits receivable on a reliable estimate of the value that is expected to be received in exchange for loss transferred.
- 1.31. The transferring undertaking should verify that the receiving undertaking is able to honor its obligations in stressed circumstances, namely after suffering the Solvency Capital Requirement stress if the receiving undertaking is subject to Solvency II.
- 1.32. The transferring undertaking should reflect any tax payable on the payment or benefit received in the recognized amount of notional deferred taxes.
- 1.33. Where the receiving solo undertaking is subject to Solvency II it should not recognize the transferred loss in the calculation of the adjustment for the loss-absorbing capacity of deferred taxes.

Section III: Adjustment for the loss-absorbing capacity of deferred taxes – recognition

Guideline 10 - Temporary nature

- 1.34. Undertakings should recognize notional deferred tax assets conditional on their temporary nature. The recognition should be based on the extent to which offsetting is permitted according to the relevant tax regimes. This may include offset against past tax liabilities or current or likely future tax liabilities.

Guideline 11 - Avoidance of double counting

- 1.35. Undertakings should ensure that deferred tax assets arising from the instantaneous loss defined in Article 207(1) of Commission Delegated Regulation 2015/35 are not supported by the same deferred tax liabilities or future taxable profits already supporting the recognition of deferred tax assets for valuation purposes in the Solvency II balance sheet in accordance with Article 75 of Solvency II.
- 1.36. Undertakings should follow in their recognition of notional deferred tax assets in a stressed Solvency II balance sheet the principles set out in Article 15 of Commission Delegated Regulation 2015/35.

Guideline 12 - Recognition based on future profits

- 1.37. If the recognition of notional deferred tax assets is supported by an assessment of future taxable profit, undertakings should recognize notional deferred tax assets to the extent it is probable that they will have sufficient future taxable profit available after suffering the instantaneous loss.
- 1.38. Undertakings should employ appropriate techniques to assess the temporary nature of the notional deferred tax assets and the timing of future taxable profits which meet the following requirements:
 - (a) The assessment is in accordance with Article 15(3) of Commission Delegated Regulation 2015/35;
 - (b) The assessment takes into account the prospects of the undertaking after suffering the instantaneous loss.

Guideline 13 - Relief where demonstration of eligibility is burdensome

- 1.39. Supervisory authorities should allow undertakings to disregard notional deferred tax assets in the calculation of the adjustment for loss-absorbing capacity where it would be too burdensome for the undertaking to demonstrate their eligibility.

Guideline 14 – Notional deferred tax liabilities

- 1.40. Without prejudice to Article 207(4) of Commission Delegated Regulation 2015/35 undertakings should include notional deferred tax liabilities resulting from the instantaneous loss defined in Article 207(1) of Commission Delegated Regulation 2015/35 in the calculation of the adjustment for the loss-absorbing capacity of deferred taxes.

Section IV: Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes at group level – General provisions

Guideline 15 - Scope

1.41. The participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should only apply the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, when method 1 or the combination of methods is used, to the part of the consolidated data determined in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35.

Section V: Adjustment for the loss-absorbing capacity of technical provisions on group level

Guideline 16 - Scenarios

1.42. Where the standard formula requires the choice between alternative scenarios, the selection should be undertaken at group level. In order to derive the loss-absorbing capacity of technical provisions in the sub-modules of the group calculation, the scenario relevant for the group should be calculated for each insurance and reinsurance undertaking that is consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35, on the basis of the application of the formula in Guideline 17.

Guideline 17 - Calculation of net basic Solvency Capital Requirement

1.43. When determining the group loss-absorbing capacity of technical provisions at sub-module level, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should derive the group's net calculation of the Solvency Capital Requirement on sub-modular level based on the following formula, considering the loss-absorbency of technical provisions of each insurance and reinsurance undertaking that is consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35, recalculated on the basis of the relevant scenario where relevant:

$$netSCR_{sub-module}^{group} = grossSCR_{sub-module}^{group} +$$

$$- \sum_{solo} \alpha^{solo} (grossSCR_{sub-module}^{solo} - netSCR_{sub-module}^{solo}) \bullet \min(1; \frac{FDB^{solo}}{grossSCR^{solo} - netSCR^{solo}})$$

Where:

- α^{solo} represents the percentage used for the establishment of the consolidated accounts;
- FDB^{solo} represents the total amount of FDB at the individual level adjusted for intra group transaction, if necessary, according to Article 339(2) of Commission Delegated Regulation 2015/35;
- $netSCR_{sub-module}^{solo}$ and $grossSCR_{sub-module}^{solo}$ should be determined in accordance with Guideline 16;

- $grossSCR^{solo}$ and $netSCR^{solo}$ represent the aggregated $netSCR_{sub-module}^{solo}$ and $grossSCR_{sub-module}^{solo}$ for each insurance and reinsurance undertaking, using either the relevant standard formula's correlation matrices or the approved internal model.

- 1.44. The value of nBSCR in Article 206(1) of Commission Delegated Regulation 2015/35 should be derived with either the aggregation matrices of the standard formula or the approved internal model. The value of future discretionary benefits in Article 206(1) of Commission Delegated Regulation 2015/35 should correspond to the part of future discretionary benefits that relates to the part of consolidated data determined in accordance with Article 335(1) (a),(b) and (c) of Commission Delegated Regulation 2015/35.

Guideline 18 – Intragroup Transactions

- 1.45. When preparing the consolidated data, if the part of the best estimate for technical provisions related to future discretionary benefits of the individual insurance and reinsurance undertakings is adjusted for intra-group transactions, in line with Article 339(2) of Commission Delegated Regulation 2015/35, the total amount of future discretionary benefits at group level should be adjusted accordingly.

Guideline 19 - Upper limit

- 1.46. The adjustment for loss-absorbency of technical provisions at group level should not exceed the sum of the adjustments for loss absorbency of technical provisions of the insurance and reinsurance undertakings consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35.

Guideline 20 - Alternative Calculation

- 1.47. Alternatively to the calculation proposed in Guideline 17, when there is a reasonable level of homogeneity among future discretionary benefits of the participating insurance and reinsurance undertaking and insurance and reinsurance undertakings that are consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35 within the group, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the Loss-Absorbing Capacity of technical provisions at group level according to Guideline 21.
- 1.48. The participating insurance and reinsurance undertaking or insurance holding company should be able to prove to the group supervisor that, according to the group business and risk profile, a reasonable level of homogeneity among future discretionary benefits within the group is ensured.

Guideline 21 - Alternative Calculation

1.49. In accordance with Guideline 20, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the adjustment for the loss-absorbing capacity of technical provisions using the following formula:

Where:
$$Adj_{TP}^{group} = \frac{SCR^{diversified*}}{\sum_{solo} \alpha^{solo} SCR^{solo*}} \times \sum_{solo} \alpha^{solo} Adj_{TP}^{solo}$$

- Adj_{TP}^{solo} is the adjustment for the loss-absorbing capacity of technical provisions of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35;

- α^{solo} represents the percentage used for the establishment of the consolidated accounts;

- the ratio $\frac{SCR^{diversified*}}{\sum_{solo} \alpha^{solo} SCR^{solo*}}$ represents the proportional adjustment due to the diversification effects at group level and, in particular, at the numerator $SCR^{diversified*}$ ⁵ is the Solvency Capital Requirement calculated on the basis of the consolidated data in accordance to Article 336(a) of Commission Delegated Regulation 2015/35 but before the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes; and the denominator SCR^{solo*} is the Solvency Capital Requirement before the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35.

⁵ $SCR^{diversified*}$ is equal to the following sum, in the case of application of the standard formula:
 $SCR^{diversified*} = BSCR^{diversified} + SCR_{operational}^{diversified}$

Section VI: Adjustment for the loss-absorbing capacity of deferred taxes at group level

Guideline 22 - Calculation

1.50. The participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the adjustment for the loss-absorbing capacity of deferred taxes according to the following formula:

Where:
$$Adj_{DT}^{group} = \frac{SCR^{diversified**}}{\sum_{solo} \alpha^{solo} SCR^{solo**}} \times \sum_{solo} \alpha^{solo} Adj_{DT}^{solo}$$

- α^{solo} represents the percentage used for the establishment of the consolidated accounts;
- Adj_{DT}^{solo} is the solo adjustment for the loss-absorbing effect of deferred taxes of each (re)insurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35;
- SCR^{solo**} is the solvency capital requirement after the LAC adjustment for technical provisions and before the LAC adjustment for deferred taxes of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of Commission Delegated Regulation 2015/35; and
- $SCR^{diversified**6}$ is the solvency capital requirement calculated on the basis of the consolidated data in accordance with Article 336(a) of Commission Delegated Regulation 2015/35 after the LAC adjustment for technical provisions and before the LAC adjustment for deferred taxes.

⁶ $SCR^{diversified**}$ is equal to the following sum, in the case of application of the standard formula:
 $SCR^{diversified**} = BSCR^{diversified} + SCR_{operational}^{diversified} + Adj_{TP}^{group}$

Compliance and Reporting Rules

- 1.51. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, national competent authorities shall make every effort to comply with guidelines and recommendations.
- 1.52. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.53. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.
- 1.54. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final Provision on Reviews

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