

## Capital management policy – principles and expectations

De Nederlandsche Bank N.V.

### Introduction

In this document, DNB explains the principles and expectations regarding the capital management policies.

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The document will start with four general principles that apply to all insurers, followed by three supplementary principles aimed at specific subsectors: Principle 5 focuses on insurers with long-term liabilities, Principle 6 on health insurers and Principle 7 on groups.

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Small and medium-sized insurers may apply the proportionality principle. Depending on the nature, size and complexity of the risks involved, the requirements for structuring and documenting their capital management policy may be less strict. This applies in particular to insurers running limited risks. Those cases where the proportionality principle may be applied, have been explicitly indicated.

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### Principle 1:

The policy is aimed at preventing frequent breaches of statutory solvency requirements.

#### Specific expectations regarding Principle 1:

- Insurers set an internal safety margin on top of the statutory solvency requirements adequate to prevent frequently breaching the statutory solvency requirements; for example, by defining one or more internal target solvency ratio's.
- The safety margin is explainable to all relevant stakeholders, is based on objectively-quantified measures, and takes into account the measures in place for recovery or adjustment (see also Principle 3). Due to differences in risk profile, complexity and size, safety margins may differ between insurance companies.
- Insurers set their safety margin based on a number of considerations, including at least the following institution-specific aspects:
  - the risk appetite, also in relation to its medium-term strategy, business plan, life cycle and market circumstances;
  - the volatility of the solvency ratio under normal conditions and in stress situations;
  - the expectations of shareholders, policy holders, rating agencies and other stakeholders;
  - any existing material risks that are not adequately reflected in the solvency requirement.

### Principle 2:

The policy takes into account the composition of own funds and planning of future composition of capital (equity and debt).

#### Specific expectations regarding Principle 2:

- Insurers describe their policy regarding composition of own funds, both with respect to the current situation and to any funds to be obtained in the future.
- Insurers take into account their business plan and the corresponding development of statutory capital requirements.
- If insurers apply leverage, the following information is to be included in the policy:
  - the goal of using leverage and period over which the leverage is expected to be used;

- the instruments used to create leverage, and whether these can be included in the eligible own funds to cover capital requirements;
- the definition of leverage that is applied and the bandwidth of the corresponding leverage ratio;
- the limits applied to the leverage ratio from the insurer's risk appetite perspective, the insurer's desired external rating and other relevant factors;
- if applicable, the manner in which grandfathered loans are phased out or replaced by instruments that fully meet Solvency II requirements;
- any intra-group loans and/or facilities used to create leverage, and the restrictions and conditions applying to them;
- the manner in which monitoring the leverage ratio is arranged.
- The policy takes into account dividend payments, repayment of capital instruments, premium refunds, profit-sharing schemes and other forms of capital withdrawal. The policy includes information on the following aspects:
  - the indicators that insurers use to assess whether a capital withdrawal is prudent, such as the solvency ratio following withdrawal, and how this relates to:
    - i) insurers' internal target(s);
    - ii) the levels at which capital strengthening measures are necessary;
  - other restrictions to withdrawals such as arrangements with supervisory authorities, including any (conditions attached to) declarations of no-objection that were granted in the past;
  - the form, size, timing and frequency of possible withdrawals and the method for determining the size of the withdrawal, e.g. as a percentage of profits;
  - the short- and long-term expectations the insurer has raised among any beneficiaries receiving the withdrawals (such as shareholders, members, etc.).
- The policy takes into account the aspects regarding the capital management plan and the planning aspects as described in Guidelines 36 and 37 (on capital management and capital management plans) of EIOPA's Guidelines on the System of Governance.
- From a proportionality perspective, mutual insurers whose articles of association clearly state that members will contribute in the event of deficiencies and will receive money in the event of surpluses do not have to supply detailed documentation on the composition of own funds, but may refer to the articles of association of the firm instead.
- For insurers who do not apply leverage and do not intend to do so in the future it is sufficient to state that they do not apply leverage and do not intend or believe it necessary to do so in the future.

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**Principle 3:**

Insurers ensure in their capital management policy that they are able to take quick and adequate measures in the event that their solvency ratio declines rapidly or falls below a critical limit.

**Specific expectations regarding Principle 3:**

- Proportionate to the size, complexity, risks and volatility of their solvency position insurers ensure that any recovery measures described in their capital management policy can actually be implemented when required by their solvency position.
- Proportionate to the size, complexity, risks and volatility of their solvency position insurers analyse the mentioned measures below for the envisaged impact, side-effects and feasibility:

- The extent of risk reduction, recapitalisation or yield increase has been substantiated and quantified;
- The key assumptions underlying the impact assessment is clearly described;
- The feasibility of the measures has also been analysed for situations in which a large number of insurers intend to implement the same measure or in which access to the market is severely restricted for any or all insurers;
- The operational impact is described (e.g. for the sale of units including specific IT systems, infrastructure, expertise, etc.);
- The impact on policy holders, shareholders and creditors has been taken into account in the analyses;
- The impact of the measure on other variables (e.g. profitability and/or leverage ratio) also being included in the analyses.
- Proportionate to the size, complexity, risks and volatility of their solvency position insurers analyse the measures for the effectiveness, implementability and processing time.
  - The processing time for each measure is charted, from the initial decision to apply a measure to its final completion;
  - The decision-making moments and bodies responsible for decision-making is charted for each measure;
  - The insurer analyses all possible impediments (legal, operational, financial or reputational) to successful implementation of measures and any mitigating measures to be taken;
  - Triggers for specific measures are set in good time in order to effectively prevent breaches of the critical solvency ratio.
- If insurers have analysed these measures in their ORSA or a recovery plan, they do not have to include these analyses again in their capital management policy. In that case it is sufficient to refer to the ORSA and/or the recovery plan.

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**Principle 4:**

Insurers periodically evaluate their capital management policy and adjust it when this is deemed necessary. Insurers also monitor their solvency ratio with a high frequency so they are able to identify its actual and expected developments in time.

**Specific expectations regarding Principle 4:**

- Proportionate to the size, complexity, risks and volatility of their solvency, insurers describe the governance regarding their capital management policy, addressing in any event the following aspects:
  - approval of policy by the insurer's highest-level policymaking body, and consent of the highest-level supervisory body;
  - if applicable, obtaining consent from the General Meeting of Shareholders;
  - review and if necessary realignment at least once every year;
  - the triggers for interim review or realignment are set, e.g. equal to the ORSA triggers (such as acquisitions or changes to the business strategy or risk policy);
  - the governance and procedural aspects as referred to in Guideline 36 and 37 of the EIOPA Guidelines for the System of Governance.
- Proportionate to the size, complexity, risks and volatility of their solvency, insurers lay down their procedures for monitoring the solvency position, addressing in any event the following aspects:
  - adequate monitoring, ensuring that declining solvency ratios are detected in time and appropriate measures can be taken through the internal governance framework;
  - frequent monitoring of triggers;

- the frequency and degree of accuracy of monitoring the solvency position, risk sensitivities and stress scenarios are proportionate to the size, complexity, risks and volatility of insurers' solvency, including the actual solvency position. The closer the solvency position moves towards critical limits, the more important the frequency and degree of accuracy for the monitoring become.
- Insurers include all relevant points of their capital management policy in their supervisory reports, and attach the capital management policy as an annex to the ORSA, unless it is already fully integrated in the ORSA.
- Insurers who are not required to draft an ORSA or supervisory report, describe their capital management policy in a separate document.

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**Principle 5 (insurers with long-term liabilities):**

Insurers with long-term liabilities (with a maturity of 20 years or more) take economic reality explicitly into account in their policy, addressing at least the impact of the extrapolation of the interest rate term structure and long-term guarantee (LTG) measures on the current and future solvency ratio.

**Specific expectations regarding Principle 5:**

- When substantiating the internal target, dividend policy and recovery measures, insurers with long-term liabilities (with a maturity of 20 years or more) explicitly take into account the impact of the economic reality on the solvency position, including in any case the extrapolation of the interest rate term structure and any LTG measures.
- Insurers explicitly include in their policy that they will draw up analyses of the solvency ratio's sensitivity to the extrapolation of the interest rate term structure and LTG measures.
- In the section on capital management of their supervisory reports, insurers include a detailed description of the difference in the accrual of the technical provisions and their solvency position in accordance with the economic reality, including in any case the extrapolation of the interest rate term structure and any LTG measures, and their technical provisions and solvency position in accordance with the Solvency II framework.

**Principle 6 (health insurers):**

Health insurers integrate their policy on setting premiums into their capital management policy.

**Specific expectations regarding Principle 6:**

- Health insurers integrate their premium policy into their capital management policy. This states clearly how available capital can be used when setting future premiums.
- As the setting of capital buffers impacts health insurers' premiums levels, the choice for a particular internal target involves more than just a risk assessment for health insurers from a social point of view. Given the mandatory nature of basic health insurance, health insurers are able to justify their safety margin both to DNB and to their external stakeholders.

**Principle 7 (insurance groups):**

The policies of the different insurers comprising a group and the policy of that group as a whole are consistent with each other.

**Specific expectations regarding Principle 7:**

- All mentioned principles and expectations apply equally to individual insurers and for groups. Groups ensure that the capital management policies of the insurers belonging to the group and of the group as a whole are consistent with each other.
- Groups substantiate the safety margin at group level, taking into account the safety margins of all insurers belonging to the group. The specific risk profiles and degree of transferability of capital within the group are important in considering where to hold the available capital within the group. Setting the safety margin at the individual insurer level as the risk-bearing party also involves setting a supplementary safety margin at the level of the group. DNB expects the individual insurers to set an adequate safety margin.
- The method for calculating group solvency can have an upward effect on the group solvency ratio due to the diversification benefit. The impact depends on the supplementary diversification between legal entities arising from calculations of the group Solvency Capital Requirement (SCR). Groups take this effect into account in setting the safety margin at the level of the group.

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**Statutory framework**

DNB bases the principles and expectations described in Annex 1 on combined provisions from the Solvency II Directive, the Delegated Acts, the Act on Financial Supervision (Wet op het financieel toezicht – Wft) and the EIOPA Guidelines. The table below specifies the relevant provisions.

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Relevant regulations	Governance	Risk ORSA Management	Group solvency & governance	RSR	Group reporting	DNO
<b>Directive</b>	41 and 93	44 45	218 and 219, 222, 223 and 246			
<b>Delegated Regulation</b>				311	308 and 359 and 372	
<b>Guidelines</b>	36 and 37					
<b>Wft</b>						3:97