

To: Solvency II Working Group

From: Prudential Team

Meeting: 7 March 2019

Reference: ECO-SLV-19-038

Subject: 2020 Solvency II review – Overview of the issues in the CfA – Overview of the issues in the CfA

Objective

For discussion

Members' input requested

Members are invited to provide feedback on the foreseen challenges and opportunities related to the 19 areas in the Call for Advice.

Comments

In its Call for Advice, the EC has identified 19 areas where it seeks EIOPA's advice. In the table below, the secretariat lists the 19 areas, with the aim of:

- Identifying challenges and opportunities
- Recapping existing positions
- Mapping existing technical material.

The analysis has been done by the Insurance Europe secretariat, and also reflects input received from the GDV and DIA.

Overview of the issues in the scope of the [CfA](#)

	Area	Mandate for EIOPA	Challenges	Opportunities	Existing Insurance Europe position and written material
1	Extrapolation of risk free interest rate term structure (Art 77a)	<p>-Provide evidence, for all currencies in the Union, on criteria to determine the LLP.</p> <p>-If any LLPs are inappropriate, then EIOPA asked to provide impact assessment to support any proposed change.</p>	<p>-EIOPA is likely to propose a shift to a 30yr LLP for EUR.</p> <p>-A shift is supported by ESRB, who “independently” proposed such a change.</p> <p>-Reference to May 2014 as the benchmark for a euro market, that is liquid to the extent that a 20 year LLP is appropriate, is missing (see Recital 30 of the Omnibus II Directive (2014/51/EU)).</p>		<p>-Insurance Europe supports stability of the RFR curve and retention of the 20yr LLP for EUR curve.</p> <p>-ESRB Regulatory risk-free yield curve properties and macroprudential consequences.</p> <p>-Assessment of the impact of changing the LLP can be found in EIOPA LTG Reports: 2017 – link 2018 - link</p>
2	Matching adjustment (Art. 77b, 77c) and volatility adjustment (Art. 77d)	<p>-Assess the efficient functioning of the VA and MA.</p> <p>-Provide an assessment of quantitative impact on best estimate and solvency position of changing VA:</p> <ul style="list-style-type: none"> • By adjusting the application ratio to reflect illiquid characteristics of individual insurers • By adopting a weighted own assets approach <p>-Provide an assessment of quantitative impact on best</p>	<p>-EIOPA’s initial work on illiquid liabilities failed to recognise the link between the liquidity of the assets and the liabilities.</p> <p>-The EC do not preclude the possibility of transitioning to a single adjustment approach.</p> <p>-The assessment seems to be focused on the role of the VA as a crisis instrument while its role as an illiquidity premium is missing.</p>	<p>-The work requested by EC broadly reflects the industry’s initial discussion on improvements to the VA and MA ie. assess a recalibrated VA and a redesigned VA.</p>	<p>-Insurance Europe position remains in development.</p>

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
		estimate and solvency position of changing MA: <ul style="list-style-type: none"> • By changing no diversification assumption. • By altering criteria for eligible assets for use in MA. 			
3	Transitional measures	-Assess ongoing appropriateness of the transitional provisions in terms of policyholder protection and level-playing field. -Assess whether ongoing possibility for companies to newly apply for transitional measures should continue.	-Possible restrictions to the use of transitional measures.	-CfA specifically requests analysis of the expired transitional measures relating to non-domestically denominated government debt (Art. 308 b (12)). This has been an issue for a number of members.	-Assessment of the transitional measures (TRFR and TTP) can be found in EIOPA LTG Reports: 2017 – link 2018 - link
4	Risk margin	-Assess whether design is still appropriate, without challenging CoC approach. -Assess appropriateness of: -RM design, in light of EIOPA's transfer value work. -assumptions on asset mix of receiving undertaking. -using a fixed CoC rate -assumptions for deriving the CoC rate (incl absence of leverage and derivation of the equity risk premium).	-Should the IAIS agree on a different approach to risk margin in the global ICS discussions, this element can create a competitive disadvantage for Europe -The exemption of interest rate risk for the reference undertaking might be at stake.	-EIOPA will have to assess the appropriateness of the RM design, as requested by the industry. -EIOPA will have to assess the flaws in its assessment of the CoC (absence of leverage/derivation of equity risk premium) which the secretariat raised in the joint IE/CFOF paper. -EC propose to include the VA and MA in the RM calculation, as suggested	-Insurance Europe response to EIOPA's second set of Advice on the 2018 review (link). -Joint Insurance Europe/CFOF paper (ECO-SLV-18-138)

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
				by industry in response to 2018 review.	
5	Capital Markets Union aspects	<ul style="list-style-type: none"> - Analyse treatment of long-term investments under Solvency II, in particular for equity and spread risks. - Identify liability characteristics that enable insurers to hold investments over the long term. - Assess correlation matrices used in standard formula. 	<ul style="list-style-type: none"> - Challenging to clearly identify long-term investments within a solvency framework which has an inherent 1-year time horizon. - Regarding correlations, EIOPA can change the structure of the modules and the calibration of the correlation parameters in the SCR standard formula. 	<ul style="list-style-type: none"> - Opportunity to raise issues on other asset classes (such as real estate) on which the SCR should be reviewed. 	<ul style="list-style-type: none"> - Insurance Europe response to the EC's proposed amendments to the Solvency II Delegated Regulation - Insurance Europe response to EIOPA request for feedback on methodological considerations on illiquid liabilities
6	Dynamic modelling of the volatility adjustment	<ul style="list-style-type: none"> - Assess whether the modelling of the dynamic volatility adjustment sets disincentives for investment and risk management strategies. - Assess appropriateness of dynamic modelling in light of VA assumptions. - Advise on criteria to improve harmonisation of modelling. 	<ul style="list-style-type: none"> - The existence of a Dynamic Volatility Adjustment appears to be questioned by the EC, even in the context of Internal Models (which makes it more difficult to argue for inclusion in the standard formula). - Increased prescriptiveness on the modelling of the DVA is likely. 		<ul style="list-style-type: none"> - EIOPA Opinion on the supervisory assessment of internal models including a dynamic volatility adjustment (link).
7	Solvency Requirement Capital standard formula	a) Assess whether the calibration of the interest rate risk	a) EIOPA shifted methodology is likely to be the starting point for future proposals. This would significantly increase capital	a) EC has requested that any proposals are suitable for all countries and should consider	a) Insurance Europe views on EIOPA's interest rate risk

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
		<p>submodule adequately reflects the risks.</p> <p>b) Assess the proportionality of counterparty default risk submodule and advise on simpler methods and calibrations where appropriate</p> <p>c) Report on: -any divergent application of insurers on the life/SLT health underwriting risk modules and non-life lapse risk sub-module. -areas where supervisory experience indicated a need for additional simplified calculations (Dir Art 109 and 111 (1)(l)) and where appropriate propose relevant methods.</p> <p>d) When stakeholders provide material qualitative data, EIOPA should assess whether this data would be a better basis for the</p>	<p>requirements for a lot of companies.</p> <p>b) \</p> <p>c) Could possibly lead to more prescriptiveness in the area of simplified calculations.</p> <p>d) An expansion of the application range of undertaking specific parameters to life underwriting risks is missing.</p> <p>e) This request is related to EIOPA's proposal in 2018 review to introduce an ex-post adjustment to capture specific insurance policy conditions within the natcat submodules.</p>	<p>interactions with parameters of RFR term structure. Therefore, refinements to EIOPA's current proposal could be expected.</p> <p>b) As counterparty default risk submodule was in scope of the 2018 review, there are no troublesome developments expected. The criteria for the residential mortgage eligibility are in scope ie. can address industry concerns about the €1 million cap.</p> <p>c) Opportunity to introduce additional simplified calculations</p> <p>d) Request may be related to EIOPA's claim that the appropriateness of the level of the mass lapse risk was not in the scope of the EC call for advice on the 2018 review. -Opportunity to provide more</p>	<p>proposals (ECO-SLV-18-112).</p> <p>b) Insurance Europe supports increased proportionality in the counterparty default risk submodule. See section 13 of Insurance Europe response to EIOPA's second set of Advice on the 2018 review (link).</p> <p>c)</p> <p>d) See section 2.3 of Insurance Europe response to EIOPA's first set of Advice on the 2018 review (link)</p> <p>e) See section 6.5.3.3 of Insurance Europe response to EIOPA's second set of Advice on the 2018 review (link).</p>

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
		<p>calibration of underwriting stresses.</p> <p>e) Provide national market average conditions that underlie the calibration of the natural catastrophe risk submodule.</p>		<p>recent/appropriate data to calibrate underwriting stresses (eg mass lapse risk, in line with Insurance Europe request in response to EIOPA's first set of advice on 2018 review).</p> <p>e) This request should increase transparency of the natcat calibrations although it is unclear how this information will make EIOPA's proposal more workable in practice.</p>	
8	Risk-mitigation techniques and other techniques used to reduce Solvency Capital Requirements	<ul style="list-style-type: none"> - Advise on methods to recognise non-proportional reinsurance covers for non-life underwriting risks. - Clarify definition of financial risk-mitigation technique 	-EIOPA has consistently rejected industry proposals to reflect non-proportional reinsurance.	<ul style="list-style-type: none"> - Find an appropriate solution for measuring risk for non-proportional reinsurance in the standard formula - Work closely with the Reinsurance Advisory Board on finding a solution - Opportunity to exclude netting arrangements from the absolute precedence of insurance claims (see Art. 275 (1) (a)). 	See response to the EIOPA consultation on the Solvency II draft advice (link)

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
9	MCR	<ul style="list-style-type: none"> - Report on the use and level of cap, floor and absolute floor - Report issues with the calculation and recommendations on how to address these - Assess whether the calculation rules are consistent with VaR of the basic OF and a confidence level of 85% over one year? - Report divergent practices in case of breach - Report issues with identification of eligible basic OF items for composite companies 	A review of cap and/or confidence level may lead to a substantial MCR increase.		
10	Macro-prudential issues	<ul style="list-style-type: none"> - Assess whether existing SII provisions allow for effective macroprudential supervision. - Where this is not the case, EIOPA should advise on how to improve ORSA, SRMP, LRMP, PPP (closed list). 	<ul style="list-style-type: none"> - There is a European workstream in the context of the 2020 SII review, but also an international workstream ie IAIS holistic framework. We will have to pay attention to how these two interact. 	<ul style="list-style-type: none"> - EIOPA will launch a consultation to prepare this response, so there is some scope to influence EIOPA's work. 	<ul style="list-style-type: none"> - Insurance Europe response to EIOPA's three macroprudential papers. - EIOPA consultation on this topic upcoming in April.

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
11	Recovery and resolution	<ul style="list-style-type: none"> - Assess whether SII rules on recovery should be further developed. - Advise whether there is a need for minimum harmonisation on resolution. - Advise what the appropriate triggers for early intervention, recovery and resolution should be. 	<ul style="list-style-type: none"> - EIOPA has already done all the work required to respond to the CfA. - In its Opinion on R&R, EIOPA called for a minimum degree of harmonisation of R&R rules. This should include a requirement for insurers to develop and maintain recovery plans. 	<ul style="list-style-type: none"> - EIOPA stated clearly that the introduction of early intervention powers should especially not result in a new pre-defined intervention level or capital requirement beyond what is envisaged in Solvency II. - EIOPA took a number of our concerns into account in its Opinion. 	<ul style="list-style-type: none"> - Insurance Europe response to EIOPA's consultation on R&R harmonisation. - EIOPA Opinion on R&R harmonisation (2017).
12	Insurance guarantee schemes (IGS)	<ul style="list-style-type: none"> - Advise whether there is a need for minimum harmonisation of national IGS rules/features. 	<ul style="list-style-type: none"> - EIOPA has already done all the work required to respond to the CfA. - In its upcoming Opinion on IGS, EIOPA will presumably propose some degree of minimum harmonisation of national IGS rules and features. - National IGS rules and features differ widely among jurisdictions, so any harmonisation will be challenging to implement. 	<ul style="list-style-type: none"> - None, as EIOPA's work is done, we strongly oppose harmonisation and EIOPA will probably propose some degree of harmonisation. 	<ul style="list-style-type: none"> - Insurance Europe response to EIOPA's consultation on IGS harmonisation. - EIOPA Opinion on IGS harmonisation expected this spring.
13	Freedom to provide services and freedom of establishment	<ul style="list-style-type: none"> - Assess sufficiency of home NCA supervisory powers - Assess whether the Home NCA is able to properly assess the fit and proper requirements (EIOPA's recent opinion on FoS highlighted that the home 	<ul style="list-style-type: none"> - EIOPA's opinion put forward the existing possibility of requiring "an external, independent valuation or verification of the technical provisions by an appropriate skilled person, with sufficient understanding of the local market" and of setting up a capital add-on 	<ul style="list-style-type: none"> - Improve regulation in case ESAs review outcome is not satisfactory - Extend the scope of colleges of supervisors to FoS/FoE material issues 	<ul style="list-style-type: none"> - Insurance Europe position on the ESAs review

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
		NCA should assess “whether the skills, knowledge and expertise of the undertaking’s personnel, including the AMSB and the key functions, are sufficient to carry out such business”).	when the home NCA considers that there is a significant deviation as regards the SCR or the governance. Costly external audits on technical provisions or capital add-ons should not be encouraged systematically when conducting business under FoS/FoE.		
14	Group supervision	Propose solutions to issues identified in the group supervision report , in particular: <ul style="list-style-type: none"> - Scope of group supervision, supervision of IGT and supervisory powers when headquarters in a non-equivalent third country - Rules for calculation of group solvency (method 1, 2 or combination), OF requirements, interaction with FICOD - Rules for calculation of minimum consolidated group SCR, level of diversification benefits - Governance requirements at group level 	<ul style="list-style-type: none"> - additional reporting requirements for internal models, intra-group transactions, risk concentration, diversification effects - harmonisation of internal models reporting - link to recovery and resolution: early intervention powers at group level, minimum harmonised framework - link to IGS: minimum harmonised framework - EIOPA’s coordinating role in group supervision should be maintained and should not undermine the group supervisor’s authority 	<ul style="list-style-type: none"> - clarification of regulation regarding definition of intra-group transactions, risk concentration, scope of group supervision. - clarification of the assessment of the eligibility of group own funds - clarification of group solvency calculation (application of Methods 1 and 2, inclusion of other financial sectors companies and application of mutatis mutandis) - formalisation of proto colleges for third country groups could improve level playing field 	<ul style="list-style-type: none"> - Insurance Europe summary of EIOPA’s report on group supervision
15	Reporting and disclosure	Assess – taking into account feedback to the EC fitness check consultation on supervisory reporting:	-Possible link to internal models and EIOPA’s investigation into supervisory convergence.	Consultation on reporting and disclosure – Achieve improvements for SFCR, RSR, QRTs and timelines.	-Insurance Europe response to the fitness check (ECO-SLV-18-041)

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
		<ul style="list-style-type: none"> - appropriateness of requirements related to reporting and disclosure, in light of supervisors/stakeholder experience - Appropriateness of volume/frequency and deadlines of reporting and disclosure. -Existing exemption requirements are sufficient to ensure proportionate application for small undertakings. 	<ul style="list-style-type: none"> -EIOPA is expected to propose new templates for internal model reporting -Avoid an increase in reporting requirements. 		<ul style="list-style-type: none"> -Final response to questions following EC workshop on fitness check of supervisory reporting requirements (ECO-SLV-19-014) -Insurance Europe views on the review of reporting requirements (ECO-SLV-18-181) -Response to EIOPA's call for input on Solvency II Reporting and Disclosure Review 2020
16	Proportionality and thresholds	<ul style="list-style-type: none"> Assess whether proportionality should be enhanced, in particular: <ul style="list-style-type: none"> - Thresholds for exclusion - Waive certain requirements based on size or nature of company/risks - Simplified calculation of immaterial sub-modules 	<ul style="list-style-type: none"> -Find an appropriate threshold for all EU Member States -Ensure level playing field regarding proportionality -Develop a risk oriented approach instead of a one-size fits all. 	<ul style="list-style-type: none"> - For small companies: raise level at which SII applies, lighter version of SII - Proportionality should include the possibility of exceptions for companies with a simple risk profile - Simplified calculations in SCR -Ease the burden for pillar 2/3 requirements 	
17	Best estimate	<ul style="list-style-type: none"> -Report on divergent supervisory practices and provide quantitative information on their impacts with regard to: <ul style="list-style-type: none"> • use of ESG; 	<ul style="list-style-type: none"> -Possible that there will be increased prescription/guidance from EIOPA on the projection of the best estimate. 		

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
		<ul style="list-style-type: none"> • definition of contract boundaries; • future management actions; • treatment of expenses, costs and valuation of options and guarantees. <p>-Advise on remedies where flaws or significant divergences in supervisory practice are identified.</p>			
18	Own funds at solo level	<p>Assess whether</p> <ul style="list-style-type: none"> - differences with banking are justified - the tiering structure induces volatility? - availability criteria are clear and appropriate - items are properly attributed to Tiers 	- No Tier 3 in banking	- No limit for Tier 2 in banking	
19	Reducing reliance on external ratings	Assess potential alternative credit assessments, in particular for large corporate exposures that are also rated by CRAs	<p>The issue of reliance on CRAs is recurring and comes from a wider G20 policy agenda. So far the industry has been successful in explaining the challenges of developing internal credit risk assessments.</p> <p>However:</p> <ul style="list-style-type: none"> i) the more "standardised"/"proxy" 		Our broader arguments on using external credit ratings can be found here

	<i>Area</i>	<i>Mandate for EIOPA</i>	<i>Challenges</i>	<i>Opportunities</i>	<i>Existing Insurance Europe position and written material</i>
			ii) approaches are developed by EIOPA, the more difficult it will be to maintain the existing arguments. the industry needs to closely monitor BoS work to ensure they don't, on own-initiative, go beyond the scope of the CfA		

Next steps

- EIOPA to publish timetable (expected in early April)