

To: Solvency II Working Group
From: Prudential Team
Date: 06-07-2017
Reference: ECO-SLV-17-120

Subject: EIOPA draft advice on Solvency II review – analysis and planning

Summary

On 4 July, EIOPA published its [first set of advice](#) to the European Commission on specific items in the Solvency II Delegated Regulation, the “summer package” (see [ECO-SLV-17-121](#)), for consultation with deadline 31 August.

The secretariat has made an initial analysis of the consultation paper to determine where previous advocacy has resulted in positive developments and where additional advocacy is needed. **Overall, Insurance Europe believes that this draft advice includes a significant number of improvements, in line with the previous Insurance Europe advocacy.** The full analysis can be found in the appendix.

Regarding **timetable** for the consultation: Over recent days, a number of members have contacted the secretariat on the issue of the consultation timetable. Views by members are mixed, namely some have indicated that they would prefer for the response to be close to finalisation in July, while others have argued that input is more likely to become available in August. **The secretariat therefore concludes that members’ input should be expected to come in at various points in time over the coming two months, and the secretariat commits to do its best to accommodate this approach.**

Regarding approach to the consultation: the secretariat believes that this consultation could be used to also comment on **areas that are not included in the scope**, but on which there have been developments since the discussion paper. One example could be the risk margin. The secretariat is asking members’ advice on this.

In term of **next steps**:

- The secretariat strongly encourages members to already engage with their member companies to identify key outstanding areas of concern.
- The secretariat has in parallel started working on a draft response (on the basis of its analysis). Members should expect to receive this draft next week – and approximately 2 weeks will be given for feedback.
- The secretariat will follow up with further iterations.

Background

EIOPA’s consultation on the Solvency II review discussion paper ended in early March and was followed by a roundtable organised on 23 May (see summary [ECO-SLV-17-088](#)), where EIOPA announced that the consultation process on the draft advice to the EC would be split in two parts. As a reminder, the summer package covers the following topics:

- Simplified calculations
- Reducing the reliance on ECAIs
- Treatment of guarantees, exposure guaranteed by a third party and exposures to RGLA
- Risk-mitigation techniques
- Undertaking specific parameters
- Look-through approach to investment related undertakings
- Information on LAC DT

Appendix – secretariat’s preliminary analysis of consultation paper

Topic	<i>Areas of improvement and where Insurance Europe’s views are reflected</i>	<i>Areas where EIOPA’s feedback is negative or potentially negative</i>
Simplified calculations	Mixed outcome. A set of new simplifications is being introduced, in line with the Insurance Europe request. However, EIOPA would not allow companies discretion by for example using further simplifications, ie beyond what will form part of the Delegated Regulation	
	<ul style="list-style-type: none"> • NSLT & Non-life lapse: introduction of a simplification, however subject to restrictions around the grouping of policies. • SLT & life lapse: introduction of a simplification, however subject to restrictions around the grouping of policies. • Mortality: introduction of a simplification. • Spread: simplification to be discussed in “reducing reliance on ECAIs” • Spread: simplification to be discussed in “reducing reliance on ECAIs”. • Market concentration: simplification to be discussed in “reducing reliance on ECAIs” • Market concentration: simplification to be discussed in “reducing reliance on ECAIs”. • Look-through: simplification to be introduced in the autumn consultation. 	<ul style="list-style-type: none"> • Simplification beyond those that will be part of the Delegated Regulation: not accepted (as seen close to an internal model approach). • Setting the SCR, by approximation, to a conservative amount to avoid the actual calculations: not accepted. • Mass lapse: proposal by industry is rejected, as not considered in the scope of the advice.
Reducing reliance on ECAIs	Mixed outcome. Positive developments around reducing the cost for standard formula users, although restrictive criteria introduced. Further work on internal credit ratings delayed to autumn advice on unrated debt.	
	<ul style="list-style-type: none"> • Requirement to nominate ECAIs: introduction of a simplification, enabling insurers to transpose a CQS3 rating to parts of their debt portfolio, not covered by contracted ECAIs (however see restriction in right hand side column). • Third-party models: EIOPA is further exploring the possibility of allowing the use of a pre-approved third-party model for the purposes of SCR calculation • Market-implied ratings and accountancy measures: excluded from being an alternative to an ECAI • Proportionality and internal credit ratings: EIOPA recognises that internal credit assessments are the best alternative to ECAIs, and also recognises that not all (re)insurers should be obliged to develop one. 	<ul style="list-style-type: none"> • Requirement to nominate ECAIs: while simplification is provided, it has restrictions related to the type of bond (ie fixed interest only) and the types of liabilities the debt backs (ie not allowed for matching adjustment, unit-linked, and profit-sharing arrangements). EIOPA is further exploring the option of applying a “minimum coverage ratio” as an additional criterion for qualifying for the simplification. It asks the industry what such a point may be. (Note: currently the average “vanilla” corporate bond portfolio coverage is 73%, so they may introduce 75% as a threshold. This introduces an arbitrary cut-off point.)
Treatment of guarantees,	Positive developments in most areas of advocacy.	

<p>exposure guaranteed by a third party and exposures to RGLA</p>	<ul style="list-style-type: none"> • RGLA guarantees: allowed in the market risk module • Partial guarantees: allowed for Type 2 exposures in the counterparty default risk module (particularly relevant for mortgages) • Exposures, guaranteed by RGLAs, but not on the list in Implementing Regulation (EU) 2015/2011: these are now also allowed for in the market risk and concentration risk sub-modules and treated as exposures with a rating of CQS 2, as per Article 180 (3). This is the so-called "intermediate treatment", transposed from CRR. 	<ul style="list-style-type: none"> • Partial guarantees not recognised in the market risk module, as EIOPA argues that presence of guarantees is embedded in CQS • Aligning RGLA lists between CRR and Solvency II: it is unclear what this alignment will entail and if this change will be positive, as on average Solvency II appears to allow a wider definition of the allowed entities (vs a granular, more prescriptive treatment for banks).
<p>Risk-mitigation techniques (RMT)</p>	<p>Positive developments on qualitative requirements for risk mitigation techniques and rolling of derivatives, consistent with Insurance Europe advocacy. Further advocacy required on recognition of other RMTs (ADCs / finite reinsurance)</p>	
	<ul style="list-style-type: none"> • Recognition of reinsurance where reinsurer is in breach of SCR: requirement on recovery plan is removed (in line with industry's request). However, the partial recognition is restricted to a period of 6 months from the point the SCR breach was disclosed. • Derivative rolling: Requirements in Article 209 are amended and clarified. The minimum tenor for exchange-traded derivatives (eg futures) is now 1 month (vs 3 months previously). OTC derivatives also have a min 1-month requirement (vs 3 months previously). "Exposure adjustments", as defined by EIOPA, have a minimum 1-week requirement, which can be shorter under extreme market moves. 	<ul style="list-style-type: none"> • EIOPA rejected initial industry proposals for ADCs and finite reinsurance, noting that they are not suitable for standard formula users.
<p>Undertaking specific parameters (USPs)</p>	<p>Mixed outcome. While an enlargement of the scope of USPs is envisaged, the data requirements and the standardised methods will remain as they are</p>	
	<ul style="list-style-type: none"> • USP for non-proportional reinsurance: introduction of a USP method that caters for stop loss reinsurance programs • Lapse risk: EIOPA invites stakeholders to provide more methods for consideration that fulfil the criterion of a "permanent and maturity independent bidirectional shock that satisfies the 99.5% VaR calibration". • USPs for nat cat: will be investigated by EIOPA Cat WS once simplification and recalibration works are over. • USPs for longevity and mortality: will be investigated at a later stage, once the calibration of mortality and longevity shocks are over. 	<ul style="list-style-type: none"> • Flexibility on the requirement of data quality: not accepted because EIOPA considers data quality as the bedrock underpinning the use of USPs. In particular, EIOPA points out that data completeness is required by the Solvency II Directive. Also, EIOPA stresses that in effect some flexibility around immaterial errors in the data is already present in the Delegated Regulation. Similarly, in the area of GSPs, relaxation of the requirements on data will not be further investigated as data quality is considered crucial. There will also be no investigation of basing GSPs on USPs for the same data quality reason and because no concrete and acceptable methodology was provided. • New standardised methods for USPs: considered not appropriate by EIOPA and therefore will not be investigated.

Look-through approach to investment related undertakings	EIOPA’s proposals are broadly in line with Insurance Europe position but further advocacy needed for simplifications in autumn package	
Information on LAC DT	<ul style="list-style-type: none"> • EIOPA proposes to extend the look-through to “investment-related undertakings” (as requested by industry). • The definition of “investment-related undertaking” is consistent with Insurance Europe’s position. 	<ul style="list-style-type: none"> • Application of look-through is proposed to be mandatory (and not optional, as Insurance Europe had asked for). • Therefore, Insurance Europe needs to 1) continue to push for optionality on the basis of arguments developed before (eg conservativeness), 2) argue for, at the minimum, optionality as a simplification.
	<ul style="list-style-type: none"> • EIOPA restricts itself in this consultation to providing an overview of the various practices across Europe, explaining what drives the differences via a linear regression, and listing the various pieces of legislation that currently govern the way LACDT is managed, including a stocktaking of the guidelines that currently exist. 	<ul style="list-style-type: none"> • “EIOPA will continue working on supervisory convergence and if deemed necessary may advise changes in the Delegated Regulation in its second response to the call for advice” [Note: The EC call for advice only request EIOPA to report on the various practices currently applied across Europe and on their impact]. • EIOPA refers to the fact that in the banking stress tests the DTA stemming from the shock were only allowed to originate from loss carry-forward [Note: this seems to mean that no future profits were allowed] which could be transposed to insurers] and the eligibility of DTA as own funds will no longer be recognised by 2018.